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83-1412

CASE NUMBER _____

# The Supreme Court of the United States

OCTOBER, 1983 term

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CITY OF CAMBRIDGE, MASSACHUSETTS,
Petitioner

v.

ROBERT W. MESERVE and BENJAMIN H. LACY,
Reorganization Trustees of the Boston
and Maine Corporation,
Respondents

---

On Writ of Certiorari to the United States
Court of Appeals for the First Circuit

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## PETITION FOR CERTIORARI

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ATTORNEY FOR APPELLANT

## QUESTION PRESENTED

Where a railroad in reorganization pays no real estate taxes to a municipality during a thirteen year administration period, is the municipality entitled to receive interest on these postpetition taxes under *Nicholas v. United States*, 384 U.S. 678 (1966) upon the consummation of a plan of reorganization which provides for the payment of interest on the claims of lower priority creditors?

## PARTIES

The City of Cambridge, Massachusetts (the "City") is a political subdivision of the Commonwealth of Massachusetts.

Robert W. Meserve and Benjamin H. Lacy, are the trustees ("Trustees") of the Boston and Maine Corporation (the "B&M"), a railroad which was the subject of reorganization proceedings under Section 77 of the Bankruptcy Act, 11 U.S.C. §205 (1977) (repealed), from March 12, 1970 through June 28, 1983.

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## STATEMENT OF JURISDICTION

The City seeks review of a judgment entered by the First Circuit Court of Appeals, in a divided decision, affirming an order of the United States District Court for the District of Massachusetts approving the Amended Plan of Reorganization (the "Plan") of the Trustees of the B&M. The effect of the judgment and order was to deny interest to the City on its prepetition and postpetition tax claims. Review is sought solely on the question of whether interest is payable on postpetition taxes.

The first circuit issued its judgment on September 30, 1983; a petition for rehearing was denied on November 17, 1983. This Court has jurisdiction to review this judgment by writ of certiorari pursuant to 28 U.S.C. §1254(a).

## STATUTES AND ORDINANCES

Bankruptcy Act Section 64a(1),
11 U.S.C. §104 (1977) (repealed)
(text set forth in appendix at 99)

Massachusetts General Laws c. 59, §57
(text set forth in appendix at 98)

## STATEMENT OF THE CASE

This case arises out of the railroad reorganization proceedings involving the Boston and Maine Corporation (the "B&M"). These proceedings were initiated on March 12, 1970 when an involuntary petition for reorganization was filed against the B&M under Section 77 of the Bankruptcy Act, 11 U.S.C. §205 (1977) (repealed). The B&M remained in reorganization for almost thirteen years until the Trustees' Amended Plan of Reorganization (the "Plan") was consummated on June 28, 1983. Pursuant to the Plan, the B&M was sold to a private investor for $24.5 million dollars on that date. The Trustees are now in the process of distributing to creditors the proceeds of that sale as well as about $48 million remaining from an earlier sale of commuter rail properties to the Massachusetts Bay Transportation Authority.

During this thirteen-year reorganization period (and for several years before), the B&M regularly paid no real estate taxes to the City of Cambridge, Massachusetts (the "City") or to other municipalities. Even though it received no tax revenue from the B&M, the City continued to supply the B&M with police and fire protection and other essential municipal services throughout the reorganization.

At the Trustees' request, the temporary deferral of the payment of real estate taxes was formally authorized by the reorganization court in an order entered on September 19, 1978. The basis for this order was that the B&M had insufficient funds both to pay current taxes and to pay other ordinary operating expenses. At various times after this order was entered, the City believing that the relative financial condition of the B&M and itself had changed, requested that the reorganization court modify its order to require the Trustees to pay future taxes as they accrued or to pay some or all of the back taxes. However, each such request was rejected.

As of June 28, 1983, the date the Plan was consummated, the B&M owed the City $3,894,980.89 in taxes which had been assessed during the reorganization period. In addition, the B&M owed the City about $361,344.23 for unpaid taxes assessed prior to the filing of the petition.

Statutory interest in the amount of approximately $2,459,197 had accrued on the principal amount of postpetition taxes owed to the City. In addition, about $381,948 in interest had accrued on the principal amount of the City's prepetition taxes in the period from the filing of the

petition to August 5, 1982.[1] Under Massachusetts law, the City's claim for outstanding taxes and interest thereon is secured by validly perfected first liens on the subject parcels.

The Plan calls for the City to receive the full principal amount of its prepetition and postpetition tax claims. However, except for the interest which had accrued on prepetition taxes as of the petition date (March 12, 1970) the City is to receive no interest on either its pre or postpetition tax claims. The Plan does provide for certain secured creditors, whose liens are of lower priority than the City's, to receive the full amount of interest which accrued during the reorganization period on their claims.

The Plan was approved by the Interstate Commerce Commission on April 26, 1982. The reorganization court conducted hearings on approval of the Plan in August, 1982. At the hearings, the City objected to the Plan because of the failure to provide for interest on either its prepetition or postpetition tax claims. Notwithstanding the City's objections, the Plan was approved by the reorganization court in an order dated December 30, 1982.

The City appealed the reorganization court's order approving the Plan to the First Circuit Court of Appeals which had jurisdiction over the case pursuant to Section 24a of the Bankruptcy Act, 11 U.S.C. §47a (1977) (repealed), and 28 U.S.C. §1291. In a divided decision entered on September 30, 1983, the first circuit entered a judgment affirming the reorganization court's order, the effect of which was to deny interest to the City on its prepetition and postpetition tax claims. The City then sought a rehearing solely on the issue of whether the court of appeals misapprehended the law in denying postpetition interest on its postpetition tax claims. The petition for rehearing was denied on November 17, 1983.

After the first circuit issued its judgment, the Trustees voluntarily paid the City the full principal amount of the prepetition and postpetition taxes owed by the B&M. It is anticipated that the interest which had accrued on the prepetition taxes as of the petition date will be paid shortly. No payment has been made on account of postpetition interest on either prepetition or postpetition taxes. The consummation order provides that the

[1] Under Massachusetts General Laws c.59, §57, taxes assessed for fiscal years commencing before July 1, 1977 bear interest at a per annum rate of eight percent. That rate was increased to ten percent per annum for taxes assessed during the period between July 1, 1977 and June 30, 1979 by Mass. St. 1976, c.250, §1, and to fourteen percent per annum for taxes assessed after July 1, 1979 by Mass. St. 1979, c.503, §1.

Trustees shall hold in escrow an amount sufficient to pay the full amount of interest the City alleges is owed on its tax claims pending final resolution of its appeal.

## ARGUMENT

The City respectfully requests that this court grant certiorari solely on the issue of whether postpetition interest is payable on its postpetition tax claims. The court of appeals' decision denying the City interest on its postpetition tax claims conflicts with the holding of this Court in *Nicholas v. United States*, 384 U.S. 678 (1966).

For almost thirteen years during the reorganization proceedings, the City furnished essential municipal services to the B&M without receiving any tax revenue in return. Such taxes are an expense of administration like "heat, light and current upkeep" and generally must be paid on a current basis. *MacGregor v. Johnson-Cowdin-Emmerich, Inc.*, 39 F. 2d 574, 576 (2nd Cir. 1930); *See, People of the State of Michigan v. Michigan Trust Company*, 286 U.S. 333, 344 (1932); *In re Boston and Maine Corp.*, 693 F. 2d 4, 5, (1st Cir. 1982); *Southern Railway Co. v. United States*, 306 F. 2d 119, 126 (5th Cir. 1962). Expenses of administration are accorded first priority under Bankruptcy Act Section 64a, 11 U.S.C. §104 (1977) (repealed). While this Court has not yet ruled on the issue, the lower courts have held that the provisions of Section 64 apply in railroad reorganizations. *In re New York, Ontario & Western Railway Company*, 25 F. Supp. 709 (S.D.N.Y. 1937); *See*, 5 Collier, "On Bankruptcy" ¶77.21 (14th ed.).

The general rule is that interest on a debtor's prepetition claims is not computed beyond the date that a petition in bankruptcy is filed. *Sexton v. Dreyfus*, 219 U.S. 339 (1911); *City of New York v. Saper*, 336 U.S. 328, 332 (1949) (taxes). This rule does not apply to claims which arise during the reorganization proceeding itself. In *Nicholas v. United States*, 384 U.S. 678 (1966), this Court held that interest is payable on taxes assessed during the reorganization and that the obligation to pay interest on such taxes continues until the case is converted from a reorganization to a liquidation proceeding. The *Nicholas* Court recognized that taxes incurred during the reorganization are administrative expenses that ought to be paid on a current basis, but must bear interest if their payment is delayed or deferred.

*Nicholas* involved a claim by the Internal Revenue Service for interest on payroll taxes which had not been paid during the reorganization. Nothing in the *Nicholas* opinion, however, suggests that its holding rests on

the particular facts or equities of that case or that its holding is limited to Chapter XI cases. The Court reviewed prior case law, involving both liquidation and reorganization proceedings and gleaned from those cases the general principle that interest is payable on taxes incurred during any period of bankruptcy administration until the debtor enters a *new* stage of bankruptcy administration beyond that in which the underlying tax obligation is incurred. Applying this principle, interest is payable on pre-petition taxes until a reorganization or liquidation petition is filed. Similarly, interest is payable on taxes incurred during a reorganization proceeding until the case is converted to a liquidation proceeding.

The Court noted that allowance of interest on debts incurred during the reorganization (including taxes) "promotes the availability of capital to a debtor in possession and enhances the likelihood of achieving the goal of the proceeding, the ultimate rehabilitation of the debtor." *Id.* at p.687. The suspension of interest once the reorganization case has been converted to a liquidation case is grounded in the administrative convenience of not continually having to redetermine interest rates, and a concern "that creditors should not be disadvantaged *vis a vis* one another by legal delays solely attributable to the time consuming procedures inherent in the administration of the bankruptcy laws." *Id.*, at p.683. Put more concretely, the Court was concerned that two creditors who might extend credit at different interest rates during the reorganization period should not be treated differently where payment is delayed not in furtherance of any rehabilitative purpose, but solely due to procedural delays inherent in the liquidation process.

The court of appeals majority attempts to distinguish *Nicholas*, on the ground that it involved a Chapter XI proceeding, not a railroad reorganization. The majority argues that *Nicholas* is not relevant because the failure of the B&M to pay postpetition taxes during the thirteen year reorganization period was due to the entry of an order by the reorganization court in 1978 authorizing the railroad to defer payment of taxes.

As the dissent correctly points out, this case is governed by former Section 77 of the Bankruptcy Act, which provides that "the rights and liabilities of creditors, and of all persons with respect to the debtor and its property, shall be the same as if a voluntary petition for adjudication had been filed and the decree of adjudication had been entered on the day when the debtor's petition was filed." 11 U.S.C. §205(1) (1977) (repealed). Nowhere in Section 77 are the courts given the power to impair the rights of governmental bodies in the recovery of tax claims against a railroad in reorganization. The clear language of the Supreme Court in

*Nicholas*, 384 U.S. at 691, states that "the strong policy of Section 64a(1) of the Bankruptcy Act . . . establishes a sharply defined priority that places all expenses of administration on a parity, including claims for taxes." Absent clear statutory support, there is no basis in law or equity for treating tax claims which are deferred during a railroad reorganization differently from other administrative claims.

The majority suggests that the reorganization court's power to defer the payment of taxes when necessary to sustain the railroads' continued operation, *See, In re Penn Central Transportation Co.*, 458 F.2d 1030 (3rd Cir. 1972), somehow encompasses the power to deny interest on such taxes when they are ultimately paid. Indeed, logic would seem to dictate quite the opposite result. Deferral of the taxes has resulted in harsher treatment for the City than that accorded other administrative creditors who have been paid currently. The payment of interest is necessary, therefore, to accord it similar treatment and to make it whole.

As Chief Judge Levin H. Campbell noted in his dissenting opinion in this case:

> "Basically, I find it hard to locate the source of the district court's power, after having forced a deferral of Cambridge's taxes, to deprive it of all interest on what was, in effect, a forced loan. I concede that there is now ample authority permitting railroad reorganization courts to cause the deferral of municipal taxes. There is no clear authority, however, empowering the denial of all postpetition interest on postpetition tax claims. Indeed, the Supreme Court has held in a related context that '[s]ince the taxes in question were incurred during the Chapter XI arrangement proceeding itself, the United States was entitled to interest on those taxes for the duration of that period.' *Nicholas v. United States*, 384 U.S. 678, 689 (1966)." (Appendix, at page 21)

The only authority cited by the majority for the proposition that denial of interest is appropriate is *In re New York, New Haven and Hartford Railroad Co.*, 304 F. Supp. 1121 (D. Conn. 1969). As the dissent points out, however, the *New Haven* case is entirely distinguishable from this case. The *New Haven* case involved the liquidation of a hopelessly insolvent railroad, whose condition was analogized to that of a "trainwreck." There, the railroad had been sustained "at the expense of the bondholders." *Id.* at 1134. All creditors had been disadvantaged by the public policy of reorganizing the railroad. Accordingly, the court noted that although "interest on unpaid post reorganization state and local tax

claims, both secured and unsecured, would normally be paid" under the circumstances, "all considerations compelled the disallowance of interest on the tax claims." *Id.* Since all creditors of the *New Haven* were being awarded reduced recoveries, the taxing authorities were merely being required to share the burden.

In the present case, the City has been singled out to bear a disproportionate share of the cost of the reorganization. Other administrative creditors have been paid on a current basis. First mortgagees and income bondholders are to receive the full amount of interest on their claims. In comparison, the City has been forced to provide the B&M with what the dissent correctly terms "an interest-free loan." It should also be noted that the precedential value of *New Haven* is diminished by the fact that no tax claimant contested the proposed treatment of its claim under the plan.

The court of appeals majority also attempts to distinguish the *Nicholas* case by asserting that the nonpayment of interest during the B&M reorganization was mandated not by a decision of the Trustees, but by the "law's delay," a phrase used by the *Nicholas* Court. To a certain extent, any postponement in the payment of a claim during a bankruptcy proceeding is caused by the law's delay. This is true not only with regard to prepetition claims, but also with regard to administrative claims the payment of which may be delayed pending the consummation of a plan of reorganization. The *Nicholas* Court acknowledged that the amount of interest that accumulates on an administrative claim depends "upon the duration of a proceeding that takes place under the direction and authority of the bankruptcy court." *Id.* at 684. But, "meaningful legal delays" occur only when an enterprise enters the period of bankruptcy administration beyond that in which the debt was incurred. The entry into the next stage marks the beginning of the type of wholly unanticipated delays during which the further accumulation of interest would produce an unfair disadvantage to certain creditors. *Id.* at 685.

The B&M reorganization case was commenced in 1970. No real estate taxes were paid to the City until the proceedings were concluded about thirteen years later. Not until 1978, did the Trustees apply to the court for an order authorizing deferral of the taxes. The reorganization court's order only ratified a unilateral decision previously made by the Trustees. Whether under Chapter XI, Chapter X or Section 77, the decision to defer payment of taxes is made in the first instance by the reorganizing debtor or trustee, presumably in the interest of fostering a reorganization, and it is difficult to see how the entry of an order ratifying this decision

changes the voluntary character of the decision.

The majority suggests that the special nature of railroad reorganization proceedings makes the decision to defer payment one imposed by law, because railroads in reorganization often must operate at a loss in the "public interest." That supposes that other types of reorganization proceedings do not involve operating losses, or are not affected by the public interest, a supposition unsupported in the record, and contradicted by experience. Many Chapter XI debtors continue in operation for a period of time despite incurring operating losses. If, for example, an important defense contractor or a major automaker were to file a petition for reorganization under Chapter XI, they would likely continue operating even if they were to incur losses.

In the end, the majority's decision misapprehends the clear mandate of *Nicholas* which was concerned with equal treatment of creditors who extend credit at the same stage of bankruptcy proceedings. The clear import of that case was that all administrative creditors, including taxing authorities, should be treated alike. *Nicholas* did not turn on the voluntariness of decisions made by debtors, or their trustees (whether ratified by court decree or not), during any period of bankruptcy administration.

The majority also asserts that the equities of this case favor nonpayment of interest to the City. It is concerned that if interest is paid to the City, unsecured prepetition creditors may receive their ten percent (10%) dividend by way of certificates of contingent interest instead of cash. The touchstone of bankruptcy administration has always been equality of treatment among creditors who are similarly situated, not a balancing of equities as between classes of creditors of different priorities. This is required by the absolute priority rule. *See*, *Consolidated Rock Products Co. v. DuBois*, 312 U.S. 510 (1941). Before weighing the balance of equities between the City and the unsecured creditors, the court of appeals was required to ensure that the City was being treated fairly in comparison to other administrative creditors.

The City's postpetition tax claims are first priority expenses of administration as well as first priority liens on the property they affect. Unlike other ordinary operating expenses incurred during the reorganization period, payment of the taxes was deferred for thirteen years without compensation to the City for the delay in payment. (While payment of the taxes was deferred, interim fee allowances were granted to the Trustees and certain attorneys.)

To deny the City interest on these deferred taxes is to require the City unfairly to underwrite the reorganization, at the expense of the essential

public interest it represents, a result against which the reorganization court in the *Penn Central* case expressly warned. *In re Penn Central*, 325 F. Supp. 294, 300.(D.Ct.Pa.1970). The unfairness of this result is accentuated by measuring the treatment of the City's first priority claims against the treatment afforded the first mortgagees and income bondholders, whose claims, even the majority concedes, "arise only after the payment from gross earnings for all necessary operating and managing expenses, proper equipment, and useful improvements." The claims of both the first mortgagees and the income bondholders are being paid in *full*, including the total amount of interest which has accrued on their claims.

The City submits that the court of appeals decision comports neither with applicable precedent of this Court nor with equity. Since the court of appeals judgment conflicts with a decision of this Court and is of exceptional importance, the City respectfully requests that this Court grant certiorari over this matter.

Respectfully submitted,

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Dated: February 13, 1984

## APPENDIX

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# United States Court of Appeals
## For the First Circuit

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No. 83-1086

IN RE
BOSTON AND MAINE CORPORATION,
Debtor.

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CITY OF CAMBRIDGE,
Appellant.

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APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MASSACHUSETTS
[Hon. Frank J. Murray, *U.S. District Judge*]

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Before
Campbell, *Chief Judge*,
Bownes, *Circuit Judge*,
and Torruella,* *District Judge*.

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*Joseph F. Ryan*, with whom *John F. Collins*, *Hirsh Freed*, *Robert E. Brooks*, *Steven B. Levine*, and *Brown, Rudnick, Freed & Gesmer* were on brief, for City of Cambridge.

*Robert M. Gargill*, with whom *John N. Garner*, *Choate, Hall & Stewart*, *Charles W. Mulcahy, Jr.*, and *Mahoney, Hawkes & Golding* were on brief, for Reorganization Trustees of Boston and Maine Corporation.

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September 30, 1983

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*Of the District of Puerto Rico, sitting by designation.

BOWNES, *Circuit Judge*. This is another, and perhaps the last, in a long line of decisions involving the reorganization of the Boston and Maine Railroad (B&M). Appellant, the City of Cambridge, appeals from an order of the district court sitting as a Reorganization Court. That order approved the final plan of reorganization for the B&M. Cambridge's objections stem from the treatment afforded its claims for taxes under the plan. Some background is necessary.

On March 12, 1970, an involuntary petition for reorganization was filed against the B&M under section 77 of the Bankruptcy Act, 11 U.S.C. §205 (1977). For some time before this date and throughout the reorganization period—March 12, 1970 through June 28, 1982—B&M did not pay taxes owed to Cambridge on a current basis. B&M's failure to pay the taxes due during the reorganization period was the result of an order of the district court on September 19, 1978, which authorized the Trustees "to defer the payment of taxes heretofore or hereafter assessed on or in connection with property of or in the possession of the Debtor or the Trustees . . . ."

Cambridge's claims for taxes are substantial. It is owed approximately $434,000 in taxes accruing prior to the filing of the reorganization petition (prepetition taxes), which includes prepetition interest, and approximately $4,026,000 in taxes accruing during the reorganization period (postpetition taxes). The reorganization plan provides for cash payment in full for these claims. It does not, however, provide for postpetition interest on the taxes owed. This interest amounts to approximately $375,000 on the prepetition taxes and approximately $1,868,000 on the postpetition taxes. It is the plan's failure to provide for postpetition interest payments to which Cambridge objects.

In assessing the district court's affirmance of the plan's disallowance of interest it must be remembered that the district court, in passing on the allowance of claims, sits as a court of equity. *Pepper* v. *Litton*, 308 U.S. 295, 307 (1939); *see Sampsell* v. *Imperial Paper & Color Corp.*, 313 U.S. 215, 219 (1941). We have previously articulated the standard of review:

> "It is not for us to pass upon the myriad factual and legal issues as though we were trying the cases *de novo*. 'It is not enough to reverse the District Court that we might have appraised the facts somewhat differently. If there is warrant for the action of the District Court, our task for review is at an end.' " *Group of Institutional Investors* v. *Chicago, M., St. P.&P.R. Co.*, 318 U.S. 523, 564.

*Boston and Maine Corp.* v. *First National Bank of Boston*, 618 F.2d 137, 141 (1st cir. 1980) (quoting *New Haven Inclusion Cases*, 399 U.S. 392, 435 (1970)). The district court's decision would, of course, not be warranted if it were the result of an error of law or based on factual findings that were clearly erroneous.

## I. INTEREST ON PREPETITION TAXES

Cambridge, in its appeal, asserts that the district court erred in holding that its prepetition secured tax lien is not entitled to payment of postpetition interest from the assets of B&M. For the reasons set forth below, we agree with the district court.

It is a well-established principle that in bankruptcy and other insolvency proceedings interest upon claims ceases to accrue at the initiation of the proceedings. *Nicholas* v. *United States*, 384 U.S. 678, 682 (1966); *City of New York* v. *Saper*, 336 U.S. 328, 332 (1949); *Vanston Bondholders Protective Committee* v. *Green*, 329 U.S. 156, 162 (1946); *Sexton* v. *Dreyfus*, 219 U.S. 339 (1911); *Thomas* v. *Western Car Co.*, 149 U.S. 95, 116–17 (1893); *Debentureholders Protective Committee of Continental Investment Corp.* v. *Continental Investment Corp.*, 679 F.2d 264, 268–69 (1st Cir.), *cert. denied*, 103 S. Ct. 192 (1982). As the Supreme Court has explained:

> Exaction of interest, where the power of a debtor to pay even his contractual obligations is suspended by law, has been prohibited because it was considered in the nature of a penalty imposed because of delay in prompt payment—a delay necessitated by law if the courts are properly to preserve and protect the estate for the benefit of all interests involved . . . . "The delay in distribution is the act of the law; it is a necessary incident to the settlement of the estate." *Thomas* v. *Western Car Co.*, 149 U.S. 95, 116–117. *Cf. American Iron Co.* v. *Seaboard Air Line*, 233 U.S. 261. Courts have felt that it would be inequitable for anyone to gain an advantage or suffer a loss because of such delay. *Sexton* v. *Dreyfus*, 219 U.S. 339, 346. Accrual of simple interest on unsecured claims in bankruptcy was prohibited in order that the administrative inconvenience of continuous recomputation of interest causing recomputation of claims could be avoided. Moreover, different creditors whose claims bore diverse interest rates or were paid by the bankruptcy court on different dates would suffer neither gain nor loss caused solely by delay.

*Vanston Bondholders Protective Committee* v. *Green*, 329 U.S. at 163–64 (footnote omitted).

Historically governmental entities' claims for past due taxes received special treatment, accruing postpetition interest until the date of payment. *See City of New York* v. *Saper*, 336 U.S. 328, 333. In *Saper*, however, the Supreme Court held that the general prohibition against the payment of postpetition interest embraced tax liens in bankruptcy cases. *Id.* at 338. *Saper*'s ban on postpetition interest for tax claims has been extended to Chapter X reorganizations, *United States* v. *Edens*, 189 F.2d 876, 877 (4th Cir. 1951), *aff'd per curiam*, 342 U.S. 912 (1952); Chapter XI arrangements, *Massachusetts* v. *Thompson*, 190 F.2d 10, 10–11 (1st Cir. 1951), *cert. denied*, 342 U.S. (1952); *United States* v. *General Engineering and Manufacturing Co.*, 188 F.2d 80, 81–83 (8th Cir. 1951), *aff'd per curiam*, 342 U.S. 912 (1952); direct actions against a debtor after the confirmation of an arrangement, *National Foundry Co.* v. *Director of Internal Revenue*, 229 F.2d 149, 150–51 (2d Cir. 1956); and Section 77 railroad reorganizations, *In re Penn Central Transportation Co.*, 358 F. Supp. 154, 170 (E.D. Penn. 1973); *In re New York, New Haven and Hartford Railroad Co.*, 304 F. Supp. 1121, 1129–32 (D. Conn. 1969).

Despite the general prohibition on the payment of postpetition interest, three exceptions have been developed by the federal courts. Interest may accrue: (1) where the bankrupt ultimately proves to be solvent; (2) where securities, held by the creditor produce income after the filing of the petition; and (3) where the amount of the secured creditor's security is sufficient to satisfy both the principal and interest due on the secured claim. *In re Walsh Construction, Inc.*, 669 F.2d 1325, 1330 (9th Cir. 1982); *In re Kerber Packing Co.*, 276 F.2d 245, 246–47 (7th Cir. 1960); *United States* v. *Bass*, 271 F.2d 129, 130 (9th Cir. 1959); *In re Macomb Trailer Coach, Inc.*, 200 F.2d 611, 613 (6th Cir.), *cert. denied*, 345 U.S. 958 (1953); *see also Debentureholders Protective Committee of Continental Investment Corp.* v. *Continental Investment Corp.*, 679 F.2d at 269 (discussing first exception); *United States* v. *Kalishman*, 346 F.2d 514, 517–18 (8th Cir. 1965) (discussing first and second exceptions), *cert. denied*, 384 U.S. 1003 (1966); *United States* v. *Harrington*, 269 F.2d 719, 720 (4th Cir. 1959) (same); *Castaner* v. *Mora*, 234 F.2d 710, 712 (1st Cir. 1956) (discussing third exception); *Kagan* v. *Industrial Washington Machine Corp.*, 182 F.2d 139, 146 (1st Cir. 1950) (same); *Oppenheimer* v. *Oldham*, 178 F.2d 386, 388–89 (5th Cir. 1949) (same).

These exceptions are not rigid doctrinal categories. Rather, they are flexible guidelines which have been developed by the courts in the exercise of their equitable powers in insolvency proceedings. The reorgani-

zation court must consider whether to grant postpetition interest, not as an abstract matter, but in light of the nature of each claim and the equities of the case before it. *In re Penn Central Transportation Co.*, 358 F. Supp. at 170; *In re Leeds Homes, Inc.*, 222 F. Supp. 20, 33 (E.D. Tenn. 1963), *aff'd* 332 F.2d 646 (6th Cir.), *cert. denied*, 379 U.S. 836 (1964); *see also In re Magnus Harmonica Corp.*, 262 F.2d 515, 518 (3d cir. 1959). At all times the reorganization court must be guided by the basic equitable principle announced in *Vanston:*

> It is manifest that the touchstone of each decision on allowance of interest in bankruptcy, receivership and reorganization has been a balance of equities between creditor and creditor or between creditors and the debtor.

*Vanston Bondholders Protective Committee* v. *Green*, 329 U.S. at 165 (citation omitted).

Cambridge contends that, having perfected its tax lien prior to the filing of the petition, it became a secured creditor in the amount of its liened claims and enjoys the same status as all other secured creditors. As such a creditor, Cambridge alleges that it falls within the ambit of the third exception and is thus entitled to postpetition interest. We disagree.

Those cases in which courts have applied the third exception, permitting postpetition interest to accrue, have generally involved mortgages, trust deeds, pledges or conditional sales contracts. In all of these circumstances, the creditor's security interest arises from a voluntarily executed agreement between the debtor and the creditor. The two parties have bargained with reference to a specific security with the expectation that the creditor may sell this security and realize the entire amount of the outstanding obligation, including interest accrued to the date of payment. *In re Kerber Packing Co.*, 276 F.2d at 247; *United States* v. *Harrington*, 269 F.2d at 723–24. To deny such a creditor postpetition interest, when the amount of the security is sufficient to cover both the principal and interest due, would undermine the faith of lenders in the efficacy of credit arrangements. Such a loss of confidence could result in a curtailing of the free flow of capital in our economy. Note, *The Federal Tax Lien in Bankruptcy: Enforceability of Liened Claims for Penalties and Post-Petition Interest*, 44 Minn. L. Rev. 1149, 1156 (1960). Thus, granting postpetition interest to mortgages and other holders of contractual liens satisfies the expectations of the parties and strikes an equitable balance between the creditors and the debtors.

The Supreme Court has never ruled on the applicability of the third

exception, granting postpetition interest when there is sufficient secured collateral, to tax liens. We agree with those federal courts of appeals which have held that the third exception does not embrace tax liens. *In re Kerber Packing Co.*, 276 F.2d at 247–48; *United States* v. *Mighell*, 273 F.2d 682, 684 (10th Cir. 1959); *United States* v. *Bass*, 271 F.2d at 131; *United States* v. *Harrington*, 269 F.2d at 723–24. A meaningful distinction can be drawn between contractual liens, such as a mortgage or deed of trust, and statutory liens, such as Cambridge's perfected tax lien. A statutory lien depends for its existence solely on a legislative act creating the lien in specified circumstances. No bargaining takes place between the debtor-taxpayer and the taxing entity which is granted a lien; the lien cannot be classified as voluntary.[1]

Further, the payment of the interest, which is secured by the lien, is not contemplated by the parties at the beginning of each tax year. Rather, the imposition of interest on unpaid taxes is more in the nature of an enforcement device assuring the collection of delinquent taxes. In the context of an insolvency proceeding, to grant the taxing entity postpetition interest on its tax lien would impose the "enforcement device" not on the insolvent debtor, but on those lower priority creditors whose claims will go unpaid. Such creditors are but innocent bystanders; they could have done nothing to effect the prompt payment of taxes and avoid the imposition of postpetition interest. To penalize these creditors for the bankrupt's inability to pay its taxes on time violates all notions of equity. *In re Cameron*, 166 F. Supp. 400, 407 (S.D. Cal. 1958) (quoting *In re Burch*, 89 F. Supp. 249, 254 (D. Kan. 1949)), *aff'd sub nom. United States* v. *Bass*, 271 F.2d 129 (9th Cir. 1959). As one federal court has explained:

> The allowance of interest [on tax claims] to the date of payment, an accumulation caused solely because of delays necessitated by the successful efforts of the Trustee to protect and increase the estate, seems to me to be entirely inequitable, and to result in an unbalance of equities between the several creditors rather than a "balance of equities" which the Supreme Court says is the touchstone of each decision.

[1] Some courts have further distinguished statutory tax liens from contractual liens on the basis that tax liens are general, applying to all of the debtor's property, whereas contractual liens are specific, attaching only to one asset. *In re Kerber Packing Co.*, 276 F.2d at 247; *United States* v. *Bass*, 271 F.2d at 131–32. This reasoning is inapplicable here, since Cambridge's lien attaches only to those parcels of real estate subject to Cambridge's property taxes.

*In re Union Fabrics, Inc.*, 73 F. Supp. 685, 688 (S.D.N.Y. 1947), *aff'd sub nom.*, *Carter* v. *United States*, 168 F.2d 272 (2d Cir. 1948), *aff'd sub nom.*, *City of New York* v. *Saper*, 336 U.S. 328 (1949).

Cambridge points to only two cases in which postpetition interest has been granted to a governmental entity on its liened tax claims. *In re Parchem*, 166 F. Supp. 724, 730 (D. Minn. 1958); *In re Ross Nursing Home*, 2 Bankr. 496, 499–500 (Bankr. E.D.N.Y. 1980). We note that both cases were decided by inferior federal courts—a district court in *Parchem*, and a bankruptcy court in *Ross Nursing Home*. We feel that both cases were wrongly decided and choose to follow the better authority of the four circuit courts of appeals which have found the third exception inapplicable to liened tax claims.[2]

In light of *Saper* and the uniform rule in the Circuit Courts of Appeals, we think it appropriate to limit the granting of postpetition interest to those exceptional situations involving creditors deemed to have bargained for specific collateral to secure both the principal obligation and interest. Further, we perceive no need, on the facts of this case, to extend the third exception to cover Cambridge's perfected tax liens. "Collection of the public revenue is a favored object, but we think today it is no more favored than that of protecting remaining creditors from the law's delay to the extent of denying post-bankruptcy interest on tax claims, liened or not." *United States* v. *Bass*, 271 F.2d at 132.

In light of the above discussion, we find that the district court acted well within its discretion in disallowing Cambridge's claim for postpetition interest on its prepetition tax claims.

[2] Cambridge also maintains that its claim for postpetition interest falls within the second exception, which grants postpetition interest to a secured creditor who holds securities which themselves produce income after the filing of the petition. Cambridge claims that it is entitled to interest on those property taxes which are attributable to property rented by the B&M to a third party. The lease between the B&M and its tenant specifies that a portion of the rent is attributable to taxes. Despite this lease provision—which we view only as a collection mechanism—we find the second exception inapplicable. This exception arises only where securities, *held by the creditor*, produce income. Here, the B&M, and not Cambridge, holds the taxable property.

## II. INTEREST ON POSTPETITION TAXES

During a period of reorganization a debtor is required to pay taxes on a current basis; they are an expense of administration. *See In re Boston and Maine Corp.*, 693 F.2d 4, 5 (1st Cir. 1982); *Southern Railway Co.* v. *United States*, 306 F.2d 119, 126 (5th Cir. 1962). In a railroad reorganization, however, the district court is afforded a measure of discretion in determining when taxes are to be paid. *See In re Boston and Maine Corp.*, 693 F.2d at 5; *In re Penn Central Transportation Co.*, 452 F.2d 1107, 1108–09 (3d Cir. 1971), *cert. denied*, 406 U.S. 944 (1972). The court's ability to defer taxes is a reflection of the special nature of a railroad reorganization. Of paramount concern is the public interest in continued operation of the railroad. In fact, liquidation is not available to a railroad. *See Continental Illinois National Bank & Trust Co.* v. *Chicago, Rock Island & Pacific Ry. Co.*, 294 U.S. 648, 671–72 (1935). "A railroad debtor simply must continue to operate, without regard to the interests or desires of its creditors, at least until such time as the constitutional rights of secured creditors under the *Brooks-Scanlon* line of cases are clearly in jeopardy." *In re Penn Central Transportation Co.*, 458 F. Supp. 1234, 1277 (E.D. Pa. 1978), *aff'd*, 596 F.2d 1102 (3d Cir. 1979). In order to facilitate the continued operation of the railroad the district court has the authority to defer payment of taxes.

In the instant case the district court deferred payment of all postpetition taxes pending reorganization. Under the proposed plan, Cambridge will recover the principal amount of these taxes, but not interest thereon. Cambridge mounts several challenges to the plan's failure to award it postpetition interest, none of which we find persuasive.

Cambridge first asserts that *Nicholas* v. *United States*, 384 U.S. 678, makes mandatory the payment of interest on debts arising during the pendency of a reorganization. It claims that the district court erred as a matter of law in approving a plan that did not provide for interest to it. We need not determine whether *Nicholas* announced a rule of law or whether, as the Trustees argue, a bankruptcy court still retains a measure of discretion and may deny interest on administration claims when the "balance of equities" counsels against such payment. The holding of *Nicholas* is not applicable in this case.

*Nicholas* followed a line of cases in which the Supreme Court discussed the allowability of claims for interest accruing during a bankruptcy proceeding. As discussed above, *Sexton* v. *Dreyfus*, 219 U.S. 339, established the general rule: interest on a debtor's obligations is not computed beyond the date that a petition in bankruptcy is filed. *Id.* at 344. *Vanston*

followed thirty-five years later, reaffirming the holding of *Sexton* and reminding "that the touchstone of each decision on allowance of interest in bankruptcy, receivership and reorganization has been a balance of equities between creditor and creditor or between creditors and the debtor." *Vanston*, 329 U.S. at 165. Then, in *City of New York* v. *Saper*, 336 U.S. 328, the Court made clear that the general principle that interest stops accruing as of the date of filing of a petition in bankruptcy is applicable to tax claims. *Id.* at 330.

*Nicholas* involved a claim for federal taxes incurred during a reorganization. The Court went a step further than the earlier cases by distinguishing among the various stages of a bankruptcy proceeding. The Court reaffirmed the justification for the general rule that interest stops as of the date of filing of a petition in bankruptcy.

> . . .*Sexton* and *Saper* reflect the broad equitable principle that creditors should not be disadvantaged *vis-a-vis* one another by legal delays attributable solely to the time-consuming procedures inherent in the administration of the bankruptcy laws. In the context of interest-bearing debts, the equitable principle enunciated in *Sexton* and *Saper* rests at bottom on an awareness of the inequity that would result if, through the continuing accumulation of interest in the course of subsequent bankruptcy proceedings, obligations bearing relatively high rates of interest were permitted to absorb the assets of a bankrupt estate whose funds were already inadequate to pay the principal of the debts owed by the estate.

*Nicholas*, 384 U.S. at 683–84 (footnotes omitted).

The Court noted a fundamental difference between debts incurred before the filing of a petition and those incurred during the reorganization itself.

> To be sure, the amount of interest that accumulates on a debt incurred during a Chapter XI arrangement depends upon the duration of a proceeding that takes place under the direction and authority of the bankruptcy court. But interest claimed on such a debt does not arise through a "delay" of the law in any meaningful sense. The underlying obligation of the debtor in possession is incurred as part of a judicial process of rehabilitation of the debtor that the procedures of Chapter XI are designed to facilitate.

*Id.* at 684–85 (citations omitted).

Thus, the *Nicholas* Court recognized that debts incurred during the reorganization itself are administration expenses that ought to be paid on

a current basis and must bear interest if any creditor is to remain willing to do business with a debtor in reorganization. *See id.* at 687. Failure to pay administration expenses during the reorganization period is the result of the debtor's own choice and not, as is true of debts incurred prior to reorganization, mandated both by law and an order of the court supervising the reorganization. Thus, the accumulation of interest on administration expenses incurred during reorganization cannot be attributed to the *law's* delay.

It is clear that the B&M's failure to pay taxes during the reorganization period was the result of the district court's order deferring payment. The railroad was unable to meet all of its current operating expenses, and this order was made to foster the purpose of the reorganization, ensuring the continued operation of the railroad in the public interest. The accumulation of interest was directly attributable to the *law's* delay, and therefore, the reasoning of *Nicholas* is not applicable to the circumstances of this reorganization.

In an ordinary reorganization a debtor that is unable to meet current operating expenses will be forced into liquidation. *See In re Penn Central Transportation Co.*, 458 F. Supp. at 1277. But since the court supervising a railroad reorganization is responsible for fostering the public interest in reviving an ailing railroad, it can delay payment of current taxes when such action is necessary to sustain the railroad's continued operation. *See Continental Illinois National Bank & Trust Co.* v. *Chicago, Rock Island & Pacific Ry. Co.*, 294 U.S. at 676 ("[A] proceeding under §77 is not an ordinary proceeding in bankruptcy. It is a special proceeding which seeks only to bring about a reorganization, if a satisfactory plan to that end can be devised.") In cases like *Nicholas*, no public interest is served in allowing a debtor to postpone payment of taxes. In the case of railroads, delay in payment reflects a public policy in favor of revival of the railroad. It would be unjust to allow interest to accumulate on court-postponed reorganization debts at the expense of other creditors.

We find support for our conclusion in *In re New York, New Haven and Hartford Railroad Co.*, 304 F. Supp. 1121. In that case state and local taxing authorities sought interest on postpetition taxes, payment of which had been postponed by court order. Judge Anderson of the Second Circuit, sitting by designation, held that *Nicholas* did not compel allowance of interest.

> [*Nicholas*'] holding that taxes incurred during a Chapter XI proceeding itself will carry interest was based upon the fact that delay

in payment was brought about as a result of the debtor's own request that it be given a chance to rehabilitate itself and not because of the "law's delay." In the case of the New Haven there was never any thought of its rehabilitating itself because it was, at the time of the petition and had been for several years prior thereto, hopelessly insolvent. The sole purpose of pursuing a §77 reorganization under the court's order, was to seek a means of keeping the New Haven in operation in the public interest. The delay was imposed upon the debtor's estate in this fashion and for this purpose. The ordered accumulation of accrued but unpaid taxes, as well as the interest on them, was not directed by the court as a matter of administrative convenience but as a matter of necessity. *Nicholas* gives recognition to and reaffirms the principle that the bankrupt estate should not be disadvantaged by means of the "law's delay."

*Id.* at 1134.

Cambridge seeks to distinguish the *New Haven* case on the grounds that the New Haven was hopelessly insolvent—"a total trainwreck"—whereas the B&M is in better financial shape. This is, to state a familiar adage, a distinction without a difference. The important factor for the court in *New Haven* was that the delay in payment of taxes was imposed by the court to foster the public interest in continued operation of the railroad. This is precisely the justification for the delay in the B&M's payment of taxes.

Cambridge further argues that the equitable justification for disallowing interest—prejudice to other creditors because of the law's delay—is absent from this case. Cambridge claims that even if interest is paid in full on its tax claims, the B&M will still have sufficient cash to meet all of its obligations under the reorganization plan. The district court found that payment of interest to Cambridge would diminish the distributive shares of general unsecured creditors; this finding is not clearly erroneous.

Under the plan, general creditors' claims are allowed at ten percent of their amount. But if there is no cash left after payment of higher priority claims, these creditors will receive Certificates of Contingent Interest (CCIs), which will expire in five years from the date of consummation. Cambridge conceded at oral argument that if B&M were presently to pay interest on the tax claims, general creditors will receive CCIs but no cash. The argument that general creditors will not be prejudiced since they will get all that they are entitled to under the plan is really one of semantics.

True, the issuance of CCIs will, under the reorganization plan, satisfy in full the claims of the general creditors. It cannot be seriously contended, however, that general creditors will not be prejudiced if there is sufficient cash to pay their claims, but the cash is diverted to satisfy claims for interest on tax debts.

The parties' dispute over the amount of cash available to pay off claims allowed under the plan revolves, for the most part, around the future profitability of investment of funds in the segregated account for settlement of claims. The district court suggested that if after all claims are settled there is sufficient cash to pay Cambridge's claim for interest it might weigh the equities differently. The plan provides that the district court will retain jurisdiction during implementation of the plan. That court is the proper one in which to raise arguments about the B&M's future ability to pay interest.

Cambridge raises three other objections to the plan, which we dispose of summarily. First, it claims that failure to award postpetition interest on postpetition taxes, an administrative expense, will subordinate its claim to those of other administrative creditors. The rule that all creditors within the same priority must be treated alike does not require that they all receive satisfaction of their claims at the same time. *See In re Penn Central Transportation Co.*, 452 F.2d at 1108. Requiring simultaneous participation "would unduly impair the flexibility so essential to a reorganization proceeding." *Id.* Furthermore, there is nothing in the record before us that indicates that all other administrative creditors have been paid in a timely manner, or that administrative debts that were postponed ultimately received interest.

Cambridge next asserts that the plan is unfair because it provides for interest payments to First Mortgages and Income Bondholders, whose claims are of a lower priority than the postpetition tax claims. This attack is based on two theories: first, that it violates the rule of *Fosdick* v. *Schall*, 99 U.S. 235 (1879), and second, that it violates the absolute priority rule. We see no merit to either theory.

*Fosdick* established the rule that administrative or current debts of a railroad must be settled before any other creditor is entitled to satisfaction of its claims. *See id.* at 252. "*Fosdick*'s principle . . . is one of mortgage law: that the mortgagee's interest attaches to *net* income, which arises only after the payment from gross earnings for all necessary operating and managing expenses, proper equipment, and useful improvements . . . ." *In re Boston and Maine Corp.*, 634 F.2d 1359, 1368 (1st Cir. 1980), *cert. denied*, 450 U.S. 982 (1981); *see also Southern Railway Co.*

v. *United States*, 306 F.2d at 126. The absolute priority rule establishes a similar proposition. Under that rule, a reorganization plan may not provide for the payment of lower priority claims before higher priority claims are fully satisfied. *See Consolidated Rock Products Co.* v. *DuBois*, 312 U.S. 510, 520–21, 527 (1941); *Case* v. *Los Angeles*, 308 U.S. 106, 116 (1939); *Northern Pacific Railway Co.* v. *Boyd*, 228 U.S. 482, 504 (1913).

Cambridge contends that the plan's awarding interest to lower priority claims of secured creditors while denying interest on its first priority administrative tax claims is an unlawful subordination of its claims. We disagree. *Fosdick* and the absolute priority rule say nothing about allowance of claims; they speak only to the order of payment to be accorded claims that the court allows under the plan. *See New York* v. *Feinberg*, 204 F.2d 502, 502–03 (2d Cir. 1953); *In re New York, New Haven and Hartford Railroad Co.*, 4 Bankr. 758, 799 (D. Conn. 1980). Since we affirm the district court's decision that Cambridge has no legal or equitable right to interest on its postpetition taxes, it has no allowable claim for interest that is even potentially in danger of subordination under the above principles.

*The district court's order approving the plan of reorganization is affirmed.*

CAMPBELL, *Chief Judge* (Concurring in part and dissenting in part). I agree with Part I of the court's opinion denying postpetition interest on prepetition taxes, since that holding appears to conform with the case law. The court's denial of postpetition interest on postpetition taxes, however, lacks adequate support.

Basically, I find it hard to locate the source of the district court's power, after having forced a deferral of Cambridge's taxes, to deprive it of all interest on what was, in effect, a forced loan. I concede that there is now ample authority permitting railroad reorganization courts to cause the deferral of municipal taxes. There is no clear authority, however, empowering the denial of all postpetition interest on postpetition tax claims. Indeed, the Supreme Court has held in a related context that "[s]ince the taxes in question were incurred during the Chapter XI arrangement proceeding itself, the United States was entitled to interest on those taxes for the duration of that period." *Nicholas* v. *United States*, 384 U.S. 678, 689 (1966).

The case falls under the former section 77 governing railroad reorganizations. That section provided that "the rights and liabilities of creditors, and of all persons with respect to the debtor and its property, shall be the same as if a voluntary petition for adjudication had been filed and a decree of adjudication had been entered on the day when the debtor's petition was filed." 11 U.S.C. §205(1) (repealed). Nowhere in section 77 are the courts given the power to impair the rights of governmental bodies in the recovery of tax claims against a railroad in reorganization. Indeed, the clear language of the Supreme Court in *Nicholas*, 384 U.S. at 691, states that "the strong policy of section 64a(1) of the Bankruptcy Act . . . establishes a sharply defined priority that places all expenses of administration on a party, including claims for taxes."[1] Although *Nicholas* applied to a Chapter XI proceeding, the principle of equal treatment of tax claims with other debts[2] seems to be applicable to railroad reorganizations given the absence of any contrary statutory provision.

[1] While the Supreme Court has not decided the issue, the lower courts have held the provisions of section 64 apply in railroad reorganizations. *In re New York, O. & W. Ry. Co.*, 25 F. Supp. 709 (S.D.N.Y. 1937); 5 Collier on Bankruptcy ¶77.21 (14th ed.).

[2] During the first half of this century prepetition tax claims were awarded postpetition interest, thus enjoying a favored status vis-a-vis other prepetition claims. This preference was abolished in *New York* v. *Saper*, 336 U.S. 328, 337 (1949), in which the Court held that "Congress assimilated taxes to other debts for all purposes, including denial of post-bankruptcy interest [on prepetition debt]."

This court states that "since the court supervising a railroad reorganization is responsible for fostering the public interest in reviving an ailing railroad, it can delay payment of current taxes . . . ." This, as I have said, is a well-established principle in railroad reorganizations, but the further point that it "would be unjust to allow interest to accumulate on court-postponed reorganization debts at the expense of other creditors," does not necessarily follow. The delay of the trustees in paying taxes disadvantaged the city, since payment of other administration debts was apparently not delayed. Thus the equities regarding the payment of interest appear to favor the city because denial of interest only exacerbates the imposition on the city, especially with respect to other claimants for administrative expenses.

The argument that the usual failure to timely pay taxes is due to "the debtor's own choice" while in this case it is due to the "law's delay" is not convincing. In *Nicholas* the Court stated,

> To be sure, the amount of interest that accumulates on a debt incurred during a Chapter XI arrangement depends on the duration of a proceeding that takes place *under the direction and authority of the bankruptcy court* . . . . But interest claimed on such a debt does not arise through a "delay" of the law in any meaningful sense. The underlying obligation of the debtor in possession is incurred as part of a judicial process of rehabilitation of the debtor that the procedures of Chapter XI are designed to facilitate.

384 U.S. at 684–85 (emphasis added). The "law's delay" in the words of the Court are "legal delays attributable solely to the time-consuming *procedures* inherent in administration of the bankruptcy laws." *Id.* at 683 (emphasis added). In *Vanston Bondholders Protective Committee* v. *Green*, 329 U.S. 156, 163 (1946), the Court stated "[e]xaction of interest, where the power of a debtor to pay even his contractual obligations is suspended by law, has been prohibited . . . ." In this case the railroad trustees requested the court to authorize deferred payment of taxes. This was the "trustees' choice," but the deferral was approved by the court as part of the attempted rehabilitation of the railroad. *See* Comment, *Bankruptcy—The Penn Central Reorganization—A Reorganization Court Has the Power to Defer Municipal and State Taxes*, 26 Rutgers L. Rev. 664, 679 (1973) (railroad reorganization court should award interest on deferred postpetition taxes at the "rate of interest the financial market would have demanded for bearing the risk this deferment entailed").

The court cites *In re New York, New Haven and Hartford Railroad Co.*, 304 F. Supp. 1121 (D. Conn. 1969), in support of the denial of postpetition interest on postpetition taxes. In that case, the "hopelessly insolvent" railroad was being operated in the public interest[3] and "was for the most part sustained at the expense of the bondholders." *Id.* at 1134. The court noted that "interest on unpaid post-reorganization state and local tax claims, both secured and unsecured, would normally be paid," but held that "all considerations compel the disallowance of interest on their claims." *Id.* The fact situation in *New Haven* is thus very different from the present case: in *New Haven*, all creditors were disadvantaged by the public policy of reorganizing the railroad, whereas in our case the City of Cambridge has taken the greatest loss (*e.g.*, the First Mortgage and Income Bondholders received interest on their claims). The strong equitable concerns present in *New Haven* are absent from this case.[4]

*In re Penn Central*, 452 F.2d 1107 (3d Cir. 1971), *cert. denied*, 406 U.S. 944 (1972), supports the proposition that payment of postpetition tax claims can be enjoined to avoid defeating a railroad reorganization. The court held that "the only viable recourse was to postpone such payment for a reasonable time, taking into consideration the competing public interests inherent in reorganizing the railroad and in maintaining the revenues of the various taxing entities affected by the injunction." *Id.* at 1109. The court only approved the injunction because (1) the record showed that the assets of the company would be sufficient to meet reasonably foreseeable first priority claims, and (2) the district court was aware of its duty to terminate the injunction at the earliest possible date. The court recognized the need to balance the public policies of saving railroads *and* of maintaining tax revenues. As the district court in *Penn Central* said, "[i]t would be inequitable to require these taxing entities to underwrite the reorganization of the debtor, at the expense of the essential public interests they represent." *In re Penn Central*, 325 F. Supp. 294, 300 (E.D. Pa. 1970).

[3] Although there is a public interest in operating a bankrupt railroad, under section 77 if the operation of the railroad endangered the constitutional rights of creditors, "the only action open to the court [was] to dismiss the petition, which would in all likelihood be followed by a State court receivership with all its attendant disadvantages." Historical Note to 11 U.S.C. §1174.

[4] The precedential value of *New Haven* is diminished by the facts that the plan provisions relating to taxes were uncontested and the court's decision was not appealed.

Thus while the power of a court to *delay* payment of taxes in railroad reorganizations cannot be denied, it is more questionable whether revenue interests of a municipality can be impaired to the degree of forcing a municipality to make an interest-free loan. If, as in *New Haven*, all creditors are awarded reduced recoveries, then the equitable powers of the court similarly extend to requiring taxing entities to share the burden. Postpetition tax claims are claims of administration, however, and I wonder if such first priority claims can be denied interest absent very special circumstances of a type which do not appear to be present here.

UNITED STATES DISTRICT COURT
DISTRICT OF MASSACHUSETTS

In the Matter of

BOSTON AND MAINE CORPORATION, No. 70-250-M

Debtor

OPINION

MURRAY, Senior District Judge

The Trustees of the Debtor in reorganization, the Boston and Maine Corporation ("B&M"), filed with the Interstate Commerce Commission ("Commission") in December 1975 their plan of reorganization, and subsequently amended the plan on December 29, 1980, again on July 15, 1981 and finally on March 3, 1982. The Commission on April 23, 1982 approved the plan as finally amended (the "Amended Plan") finding that "the Amended Plan, which provides for the conservative capitalization of B&M on essentially an all equity basis and provides for continuation of the existing service on a vital link of the New England Rail System, satisfies all relevant statutory criteria and is in the public interest." (I.C.C. Decision at 25).[1] The Commission certified the Amended Plan to this court on June 28, 1982.[2]

Viewed broadly, the goal of the Trustees under the Amended Plan is a Boston and Maine Corporation reorganized and continuing as an operating railroad with a revised capitalization on a substantially all equity basis, with all of the outstanding new Common Stock issued to Guilford Transportation Industries, Inc. ("Guilford") (thus vesting in Guilford control of the reorganized corporation), in the expectation that B&M thus reorganized will be a financially viable operating railroad capable of providing rail commuter service, under contract with Massachusetts Bay Transportation Authority ("MBTA"), and freight service over existing rail lines (including many of the lines presently utilized for commuter rail service).

Since 1970 B&M has been in this court in reorganization proceedings under Section 77, and before referring to the significant features of the Amended Plan and the issues involved in the question of its approval, it is well to begin with a brief history of the proceedings.

## I

On March 12, 1970 several bondholders (herein the "Group of Institutional Bondholders")[3] filed in this court a petition for reorganization of B&M under the provisions of Section 77. For many years prior to 1970 B&M had been in poor financial health, having suffered uninterrupted deficits in net income, debts arising from unpaid property taxes and unpaid interest on its bonds, and a decline in traffic and earnings resulting from a twelve-year period of inadequate capital expenditures.[4] It was upon the failure of B&M to pay the interest due on the First Mortgage bonds as of February of 1970 that these reorganization proceedings were instituted. Charles W. Bartlett, Esquire, Paul Cherington, and Robert W. Meserve, Esquire, were appointed by the court to serve as Trustees[5] of the Debtor's property.

The debts owed by B&M and the claims against it on March 12, 1970, the date of bankruptcy, were as follows:[6]

| | |
|---|---|
| *Secured claims* | |
| Bondholders and Creditors holding Securities | $ 81,779,442.30 |
| Real Estate and Other Tax Claims | 7,621,704.10 |
| *Unsecured claims* | |
| Personal Injury and Property Damage | 1,896,355.06 |
| Interline Per Diem Claims | 11,284,587.23 |
| Interline Freight/Overcharge Claims | 567,763.86 |
| Shippers and Consignees Freight Claims | 2,972,492.00 |
| Shippers and Consignees Overcharge Claims | 173,657.50 |
| Private Car Hire | 503,653.43 |
| Materials, Supplies, and Services Rendered | 8,600,327.98 |
| Total | $115,399,983.46 |

Within the first year following the filing of the bondholders' petition, separate plans of reorganization were filed with the Commission by the petitioning bondholders and by the directors of B&M. Both plans sought inclusion of B&M in the Norfolk & Western Ry. system and failing that, abandonment and liquidation of the properties of B&M. The Trustees of the Debtor also petitioned the Commission for inclusion of B&M in the Norfolk & Western Ry. system. In addition, the petitioning bondholders, gravely concerned that the railroad might not be financially able to continue operations, applied to the Commission for abandonment of the entire B&M rail lines. By mid-1971, however, it appeared there was no immi-

nent likelihood of interruption of B&M's rail service for lack of operating funds, and on September 29, 1971 the Commission rejected the pending plans of reorganization, and denied the Trustees' petition for inclusion of the Debtor in the Norfolk & Western Ry. system and the bondholders' application for abandonment.

In December of 1971 the Trustees filed an "interim or contingency" plan of reorganization which, along with alternative plans of reorganization filed by Amoskeag Company and by the Group of Institutional Bondholders, became the subject of extensive hearings before an Adminstrative Law Judge in 1972. The Commission adopted the report of the Administrative Law Judge, filed on February 13, 1973, that the Trustees' plan was basically sound and the proposals valid, but that additional measures were required to provide for a modified capital structure, reduction of taxes and an adequate cash flow before B&M could satisfy its creditors and become a profitable railroad operation. The interim plan was approved as modified by the discussion and conclusions in the report of the Administrative Law Judge, and the Trustees were directed by the Commission to file a definitive plan on or before June 30, 1974. The plans of Amoskeag Company and the Group of Institutional Bondholders were rejected.

The plan of reorganization next proposed by the Trustees was the 1975 Plan, filed with the court on December 12, 1975,[7] which contemplated reorganization of B&M in two steps. A definitive First Step, which the Commission and the court approved in 1976, provided for the sale by B&M to MBTA for $39.5 million in cash of the commuter rail lines radiating northerly and westerly from the North Station in Boston, and certain other properties. The conveyance by the Trustees of the rail lines to MBTA was subject to the reservation in perpetuity of an easement by the Trustees to operate freight service over the lines. It was further provided under the First Step that the Trustees would continue to operate the commuter rail service, under an operating agreement with MBTA, over the rail lines conveyed. The Second Step comprised measures to be taken to satisfy claims of creditors against the Debtor's estate and to recapitalize B&M.

The commuter rail lines (and other properties) were conveyed to MBTA on December 26, 1976 free and clear of all claims, except the reserved easement. On January 1, 1977 the operating agreement became operative. During 1977 the court approved a second operating agreement between B&M and MBTA covering commuter rail service over additional commuter rail lines extending southerly and southwesterly from

the South Station in Boston, which service had previously been provided by Consolidated Rail Corporation ("ConRail"). Under this agreement B&M, in the latter part of 1977, undertook operations of the commuter rail service from the South Station.

The Trustees were not at this point in a position to carry out the Second Step of the 1975 Plan because of the heavy operating loss sustained in 1976. Believing that existing conditions offered dim prospects for precise implementation of the Second Step, the Trustees petitioned the court for authority to use the major share of the proceeds of the sale to MBTA to finance an interim tender offer to redeem the Debtor's First Mortgage bonds at a discount. In 1979 the Trustees were authorized to use $33.06 million (of the $39.5 million proceeds of the sale to MBTA) to acquire (at the discounted price of $800 per bond) the First Mortgage bonds of B&M and accrued unpaid interest thereon. The tender offer resulted in the acquisition and retirement of $36,992,000 principal amount of the bonds, thus reducing the amount of principal indebtedness of the bonds outstanding to $9,944,976 and increasing the Debtor's net worth.

A significant move directed toward ultimate reorganization was initiated by the Trustees in 1978 when they sought and were granted authorization to enter into a financing agreement with Federal Railroad Administration ("FRA") for rehabilitation of B&M's main line between Ayer, Massachusetts and Mechanicville, New York. Under the agreement dated September 29, 1978, FRA loaned the Trustees $26.0 million in cash in exchange for Trustees' certificates of indebtedness in the face amount of the loan. The rehabilitation was completed in 1981, resulted in a major rebuilding of B&M's heaviest density line and upgraded the line, in large part, to Class IV standard.

The amendment to the 1975 Plan that was filed with the court on December 31, 1980 was transmitted to the Commission which established a schedule of proceedings for consideration of the Plan as most recently amended. Before any consideration was given to the Plan under the schedule, the Trustees had concluded certain negotiations with Timothy Mellon of Guilford, Connecticut, which resulted in the execution of a "Letter of Intent" on April 15, 1981 concerning the acquisition of B&M by Guilford Transportation Industries, Inc.[8] On July 15, 1981 the Letter of Intent was superseded by an Acquisition Agreement entered into by the parties. It is sufficient to note here, in concluding this brief history of the reorganization proceedings, that the Acquisition Agreement contemplates that Guilford will become owner of all of the outstanding new Common Stock and assume control of the reorganized B&M.

II

Soon after reorganization proceedings were commenced, the Trustees began an abandonment study of lines that were unprofitable in operation. A number of branch lines were operating at very low traffic density at out-of-pocket loss. Some of the branches had been receiving little or no maintenance and if continued in operation B&M would have had to restore the lines to normal maintenance condition at heavy expense. The Trustees sought and were given authority to abandon freight service over approximately 280 miles of lines. Approximately 65 additional miles of lines are, or may become, the subject of further abandonment petitions.

Presently, B&M operates over approximately 1416 miles of owned or leased track in the states of Massachusetts, Maine, New Hampshire, Vermont, Connecticut and New York. B&M is primarily a carrier of freight, but, as noted above, it also operates commuter rail service from Boston's North and South Stations for the account of MBTA.

B&M's main line runs east/west from Rotterdam Junction, New York through Mechanicville, New York to Ayer, Massachusetts, a distance of 165 miles. At Mechanicville there is an interchange with the Delaware and Hudson Railroad ("D&H"), and at Rotterdam Junction B&M interchanges traffic with ConRail. That portion of the main line between Fitchburg and Greenfield, Massachusetts, approximately 56 miles, is leased by B&M from the Vermont and Massachusetts Railroad under a 999-year lease. As already mentioned, this east/west main line is maintained at Class IV standard.

B&M operates over the 118-mile line between Ayer and South Portland, Maine, where it interchanges traffic with the Maine Central Railroad through the Portland Terminal Company. The 13-mile portion of this line between Willows and North Chelmsford, Massachusetts, is leased by B&M from Stony Brook Railroad Company (in which B&M owns a controlling, 60% interest) under a lease that expires in 1989. This line is maintained at Class III standard.

The Connecticut River Line of B&M lies between Springfield, Massachusetts and Wells River, Vermont, a distance of 164 miles, and is maintained at Class III standard. This line makes a junction with B&M's east/west main line at East Deerfield, Massachusetts. The line continues northerly from the junction through Greenfield, Massachusetts to Bellows Falls, Vermont, where it connects with the Central Vermont Railroad (a subsidiary of the Canadian National Railroad), and continues still northerly to White River Junction, Vermont, thence to Wells River, Ver-

mont and Whitefield, New Hampshire, and ultimately to Berlin and Groveton, New Hampshire, where the line connects with the Canadian National Railroad ("CN"). The Central Vermont Railroad ("CV") owns approximately 14 miles of the Connecticut River Line between White River Junction and Windsor, Vermont, and 11 miles between Brattleboro and East Northfield, Vermont, and CV has granted trackage rights to B&M over these portions of the line. At White River Junction there is a traffic interchange with CV; at Woodsville, Vermont, near Wells River, there is a traffic interchange with CN; and at Whitefield, a connection with the Maine Central Railroad. Using B&M crews, Amtrak operates one "Montrealer" passenger train per day in each direction over the Connecticut River Line.

B&M operates its New Hampshire Line approximately 45 miles from North Chelmsford, Massachusetts to Concord, New Hampshire, and serves the principal New Hampshire cities of Concord, Manchester and Nashua. This line is maintained at Class III standard.

In addition, B&M operates several light density freight lines. The most significant of these may be described as follows:

(a) The Groveton and Berlin Branch connecting the James River Corporation plant in Berlin and the Groveton Paper Company plant in Groveton to the Connecticut River Line at Wells River. (The Berlin Mills Railway, a short line, operates the Berlin Yard for B&M.)

(b) The Conway Branch running north from the Ayer/Portland line at Rollingsford, New Hampshire to Ossipee, New Hampshire.

(c) The Ashuelot Line connecting Keene, New Hampshire with the Connecticut River Line at Brattleboro. (The Green Mountain Railroad, a short line, operates the Keene Yard for B&M.)

The commuter rail service, which B&M operates for the account of MBTA from Boston's North and South Stations, is a very important passenger service. MBTA owns or leases the equipment used in the commuter service, and B&M supplies all of the operating and supporting personnel. Operations under the agreement with MBTA for commuter rail service represent almost one-third of B&M's activity as measured by the operating expenses.

In December of 1981, the court by Order No. 629 authorized the Trustees to purchase from ConRail certain railroad lines, rights and properties located in Connecticut and western Massachusetts and assume the freight service obligations of ConRail appertaining thereto. The Trustees also

obtained trackage, operating and reciprocal switching rights over approximately 93 miles of track, and trackage rights over approximately 3.1 miles of track, in Massachusetts and Connecticut, in order to facilitate operations over the railroad lines acquired from ConRail.[9]

III

The First Step of the Trustees' 1975 Plan had been fully achieved when the July 15, 1981 amendment, which reflected Guilford's proposal to acquire control of B&M, was filed with the Commission and the court.

In the July 15, 1981 amendment the Trustees proposed measures by which they expected both to satisfy claims of creditors and to revise the capitalization of B&M. The Trustees submitted to the Commission their so-called "Amended Plan", incorporating the amendment of July 15, 1981; and subsequently the Trustees submitted an additional amendment which they filed with the Commission on March 3, 1982. The Commission approved the final version of the plan with all amendments thereto.

A

The Amended Plan provides for a revision of the capitalization of B&M by cancelling the presently outstanding preferred and common stock, and by authorizing the creation of new capital stock as follows:

(a) 3.000,000 shares of new Common Stock of the par value of $1 per share, and

(b) 2560 Redeemable Preference Shares, Series A, and 40 Redeemable Preference Shares, Series B, of the par value of $10,000 per share.

The Plan calls for issuance to Guilford of all of the outstanding new Common Stock, that is, a total of 2,425,000 shares, in consideration of Guilford's payment of $24,250,000 in cash to the reorganized B&M. Thus the Plan does not call for issuance at this time of the full number of shares of new Common Stock authorized. The Plan also provides for issuance of all 2600 Redeemable Preference Shares to the United States Government in exchange for the Trustees' certificates of indebtedness of $26.0 million, issued in 1978 for the loan made by FRA to the Trustees. No dividends or payments of principal will be due on the Redeemable Preference Shares prior to 1989. It is provided under section 3.1(1) of the Plan that the holders of the new Common Stock, in the event of liquidation or winding-up of the reorganized B&M, shall be entitled to receive $10

per share out of the assets available for distribution to stockholders before any distribution is made to holders of Redeemable Preference Shares. The holders of the Redeemable Preference Shares would then be entitled to receive the par value of their shares before further distribution would be made to holders of the new Common Stock.[10]

Preference Shares Series A will issue in an amount equivalent to loans made by FRA for the elimination of deferred maintenance of B&M's main line, and the annual dividend payable, commencing in 1989, on such shares will be at the rate of 4.2 percent per annum on the outstanding par value of such shares. Preference Shares Series B will issue in an amount equivalent to loans made by FRA for work deemed by FRA not to constitute deferred maintenance, and the annual dividend payable, commencing in 1989, on such shares will be at the rate of 8.89 percent per annum on the outstanding par value of such shares. Series A shares will receive annual "level service" payments of $750 (the dividend plus the mandatory redemption installment) per share commencing in 1989 and payable to 2008, when the shares will be fully paid out. The annual "level service" payments from 1989 to 2008 on Series B shares will be at the rate of $2547.22 per share.

B

The reorganized B&M will be authorized under the Amended Plan to issue Certificates of Contingent Interest (CCIs) in four series, designated in order of priority Series, A, B, C and D.

Series A CCIs may be issued in the aggregate face amount by which the amount of cash available may be found insufficient on the Consummation Date to fully satisfy the claims of the holders of the Income Bonds.

Series B CCIs may issue in the aggregate amount equal to the face value of all claims of the United States arising under Title 31 U.S.C. §191.[11]

Series C CCIs may issue in the aggregate face amount equal to all tax claims, which have not been waived and which are not secured by valid liens of federal, state and local taxing authorities, that are found to be based on valid assessments and to have become legally due and owing within three years preceding March 12, 1970, or otherwise entitled to priority under the Bankruptcy Act.

Series D CCIs may issue in the aggregate face amount equal to ten percent of the total principal amount of liquidated and allowed claims of general unsecured creditors.

The holders of the CCIs will be entitled to receive payment of the face

amount, without interest, of the CCIs *only* from the cash in the Segregated Account[12] that is in excess of the amounts needed for payment of senior claims. CCIs will be payable in order of priority among the four series, and *pro rata* within each series, in whole or in part, from time to time when it is determined by the Trustees that excess cash is available. To the extent that CCIs have not been paid in full within five years after the date of consummation of the Plan, such CCIs will be cancelled automatically and the holders thereof will have no further claims against the reorganized B&M for the unpaid balance of such CCIs.

C

The claims against the Debtor's estate that have been acknowledged by the Trustees are as follows:

| | |
|---|---|
| (a) Administration claims | $ 3,000,000 |
| (b) Lien-tax claims | 8,600,000 |
| (c) Claims of Six Months creditors [11 U.S.C. §205(b)] | 3,000,000 |
| (d) First Mortgage bonds, principal and accrued interest | 17,655,000 |
| (e) Income bonds, principal and accrued interest | 37,276,000 |
| (f) Claims of the United States under 31 U.S.C. §191, and State of New Hampshire Public Utilities Tax | 40,000 |
| (g) Claims of general unsecured creditors | 15,050,000 |
| (h) 5% Preferred Stock ( shares) | — |
| (i) Common Stock ( shares) | — |
| | $84,621,000[13] |

The Trustees had on deposit in their Restricted Funds Account (Account No. 716) as of June 30, 1982 the sum of $47,970,771. The funds in this account are comprised mostly of the proceeds of sales of property of the Debtor, subject to the liens of the First Mortgage bonds and Income bonds, and the interest accrued from investment of the proceeds. The $47,970,771 was exclusive of the Debtor's current cash and cash equivalents in Accounts No. 701 and No. 702, and the special deposits in Account No. 703.[14]

Under the Plan, $5,250,000 of the cash in Accounts No. 701 and No. 702 on the Consummation Date will be paid over to the reorganized B&M. To the extent that the cash in those two accounts is less than $5,250,000 the deficiency shall be paid from the Segregated Account to the reorga-

nized B&M before any cash is distributed to creditors.

Assuming consummation of the Plan had occurred on June 30, 1982, the Trustees would have distributed the available cash consisting of the $47,970.771 in Account No. 716 and the $24,250,000 to be paid by Guilford for the new Common Stock, a total of $72,220,771.[15] This sum would have been adequate to pay the amounts allotted to the classes of claims listed above, except for the following: (g) the general unsecured claims; and (h) and (i), any amount on the presently outstanding preferred and common stock.

The Plan provides that the claims of the general unsecured creditors will be satisfied by the issuance of Series D CCIs in the aggregate face amount equal to ten percent of the total liquidated and allowed claims. There are no provisions in the Plan for payment of any cash, or issuance of any options or warrants to acquire securities of the reorganized B&M, to the holders of presently outstanding preferred and common stock. Instead, the Trustees request in section 3.10 that the Commission find and the court affirm that such stock has no value.

The cash of the Debtor available for distribution to the creditors will be paid in the order of priority set out in section 3.3(2) of the Plan—the order set forth in the above listing. In section 3.9 of the Plan it is provided that any cash remaining in the Segregated Account after making the cash payments to claimants as required by section 3.3 shall be paid over to the reorganized B&M as additional working capital.

D

The Trustees, in section 4.1 of the Plan, expressly affirm the leases (as of March 12, 1970) of the properties of The Northern Railroad, the Stony Branch Railroad, and the Vermont and Massachusetts Railroad, including the amendments in each lease. A schedule of the executory contracts that will be assumed by the reorganized B&M has been filed with the court as provided in section 4.2. Other executory contracts, which the Trustees have rejected as of March 12, 1970, as provided in section 4.3, are identified in an Exhibit filed with the court.

As of the Consummation Date all of the property remaining in the Debtor's estate will, as provided in section 4.5 of the Plan, be transferred and conveyed to the reorganized B&M free and clear of all claims or creditors and stockholders of the Debtor.

IV

Pursuant to Section 77(e) the court by order entered July 7, 1982 (A) fixed the time within which (1) objections to the Amended Plan certified by the Commission, (2) claims for equitable treatment, and (3) statements of position, might be filed with the court; (B) established August 11, 1982 as the date of hearing of the objections and claims; and (C) provided for the giving of due notice of the hearing by the Trustees to creditors, stockholders and all other parties in interest. Notice of entry of the July 7 order was given by the Trustees in accordance with the directions of the court contained therein. Objections to the Amended Plan were filed pursuant to the order, and there were also filed claims for equitable treatment and statements of position. Among the responses filed was the motion of Canadian Pacific Ltd. ("CP") requesting that the court defer decision on the question of approval of the Amended Plan until such time as the Court of Appeals for the District of Columbia Circuit decided certain petitions for review of the Commission's decision approving the Trustees' Amended Plan (the plan presently before the court in this proceeding).

The hearing was held August 11 and 12, 1982, pursuant to the order entered July 7, at which all parties in interest were afforded opportunity to be heard in support of and opposition to the objections and claims for equitable treatment, and in support of and opposition to the motion of CP. The parties who appeared and argued to the court on the objections, claims or the motion of CP are identified in the margin.[16] The hearing was closed after the conclusion of the oral arguments and after the court fixed August 23, 1982 as the time within which a party in interest might file a memorandum on the issues raised before the court during the hearings.

On August 26, 1982 the court, on its own initiative, entered an order giving notice of the reopening of the hearing, and scheduling a further hearing to be held September 16, 1982 for the limited purpose of receiving evidence of "the approximate amounts to be paid by the Debtor [or by any corporation or corporations acquiring the Debtor's assets] for expenses and fees incident to the reorganization" in accordance with the provisions of Section 77(e)(2). Notice of entry of the August 26 order was given by the Trustees to all persons who rendered services and incurred expenses incident to the reorganization, in accordance with the directions of the court set out in the order. The order provided that any person seeking compensation and reimbursement for expenses incident to the reorganization might, in lieu of presenting oral evidence at the hearing, file with the court a statement of the services rendered, or to be ren-

dered, and the expenses incurred, substantially in the manner and form of the statement required by Bankruptcy Rule 8-212(a). The persons who appeared and addressed the court in response to the matters contained in the order or who filed statements with the court are identified in the margin.[17]

Thus the record of the proceedings on the question of approval of the Amended Plan demonstrates that all parties in interest have had an opportunity to be heard, and that all classes of creditors and stockholders have had an opportunity to present their claims and argue the same to the Commission and to the court.

Section 77(d) provides that if the Commission approves a plan, it shall certify to the court the plan "together with a transcript of the proceedings before it and a copy of the report and order approving the plan". In the Commission's decision in this case, the Commission noted that it had consolidated for concurrent disposition the Amended Plan and Guilford's application (filed October 28, 1981) for authority to control B&M, the Commission stating it did so "[i]n view of the interrelationship between the control application and the . . . Amended Plan". (I.C.C. Decision at 5). The record and transcript certified to the court comprise the complete record and transcript of the consolidated proceedings before the Commission on the Amended Plan and the control application. The record contains written verified statements of witnesses on direct evidence on the Plan and control application, and on "responsive applications" filed by other parties, and testimony developed under cross-examination of witnesses at public hearings before an Administrative Law Judge. The testimony of some witnesses in the record relates only to the control application, and the testimony of other witnesses relates to both the Amended Plan and the control application. The consolidated record was not separated as between the Plan and the control application. While recognizing that "an integral relationship exists between [Guilford's] control of B&M and that carrier's reorganization",[18] the Commission made clear the basis of its decision to approve the Plan, as follows:

> We are approving the Amended Plan of Reorganization because it satisfies the requirements of section 77(b) and (e) of the former Bankruptcy Act and is compatible with the public interest. The Trustees have established the viability of a reorganized B&M on the basis of its realistic earning potential.

(I.C.C. Decision at 4).

## V

Section 77 contemplates that "[t]he judicial functions of the [reorganization] court and the administrative functions of the Commission [will] work cooperatively in reorganizations". (Footnote omitted). *Warren v. Palmer*, 310 U.S. 132, 138 (1940). Upon certification of the plan by the Commission, Section 77(e) in part provides that the judge, after hearing, shall "approve the plan if satisfied that . . . [i]t complies with the provisions of subsection (b) of this section, is fair and equitable, affords due recognition to the rights of each class of creditors and stockholders, does not discriminate unfairly in favor of any class of creditors or stockholders, and will conform to the requirements of the law of the land regarding the participation of the various classes of creditors and stockholders . . .". In reviewing the plan, "[t]he power of the court does not extend to participation in all responsibilities of the Commission. Valuation is a function limited to the Commission, without the necessity of approval by the court . . . . The function of valuation thus left to the Commission is the determination of the worth of the property valued, whether stated in dollars, in securities or otherwise". *Ecker v. Western Pacific R. Corp.*, 318 U.S. 448, 472 (1943). While it is clear that the statutory scheme vests in the Commission (and not in the court) the determination of value of the property on which the plan of reorganization depends, it remains for the reorganization court to ascertain, within the statutory scheme, whether the Commission's determination is supported by material evidence and is in accordance with legal standards. *Id.* at 477. So long as the record demonstrates both (1) the requisite support for the Commission's findings of fact and conclusion on valuation and (2) the application of correct principles by the Commission in reaching its findings and conclusion, it is not the function of the court to reexamine those findings or that conclusion.

The statutory provisions for valuation of a railroad in reorganization are set forth in Section 77(e) (¶4):

> If it shall be necessary to determine the value of any property for any purpose under this section, the Commission shall determine such value and certify the same to the court in its report on the plan. The value of any property used in railroad operation shall be determined on a basis which will give due consideration to the earning power of the property, past, present, and prospective, and all other relevant facts. In determining such value only such effect shall be given to the present cost of reproduction new and less depreciation and orig-

inal cost of the property, and the actual investment therein, as may be required under the law of the land, in light of its earning power and all other relevant facts.

Under the Amended Plan, the value of the reorganized B&M consists in the expectation of income from its use of productive property. In such case the earning power of the property is the primary factor in determining the value of the enterprise as an operating railroad. *Group of Institutional Investors v. Chicago, Milwaukee, St. Paul & Pacific Railroad Co.*, 318 U.S. 523, 539–40 (1943); *Ecker v. Western Pacific R. Corp.*, *supra* at 507. "The extent and method of inquiry necessary for a valuation based on earning capacity are necessarily dependent on the facts of each case." *Consolidated Rock Co. v. Du Bois*, 312 U.S. 510, 527 (1941).

A

The Commission's determination of the value of the reorganized B&M is about $24,250,000. (I.C.C. Decision at 24). *See Ecker v. Western Pacific R. Corp.*, *supra* at 481, 483. The Commission had before it evidence pertaining to past operating revenues and income, the system's physical restructuring and condition, improvements at the management level, and forecasts to 1985 of tonnage, revenues, expenditures, and income. Overall there was adequate evidence of relevant future earning power of the reorganized B&M, and, in addition, there were opinions of value of the reorganized B&M given by witnesses called by the Trustees. The Commission found that the Trustees have established the requisite viability of the reorganized B&M on the basis of its realistic earning potential, *id.* at 19, having found that the record establishes that the reorganized B&M will produce sufficient earnings to justify approval of the Amended Plan.[19]

The Amended Plan calls for a *pro forma* capitalization of the reorganized B&M totalling $60,525,000, as of January 1, 1982, comprised of total debt of $10,275,000 and total shareholder's equity of $50,250,000. The debt portion consisted of equipment obligations in the amount of $1,106,000, and capital leases of $9,169,000. Shareholder's equity included the $26 million of Redeemable Preference Shares, and $2,425,000 allocated to 2,425,000 shares of new Common Stock (of $1 par value per share) and $21,825,000 to paid-in capital.

The *pro forma* capitalization reflects the elimination of the Debtor's mortgage debt and the conversion of the Trustees' Certificates, previously delivered to FRA, to the subordinated Redeemable Preference

Shares, and demonstrates that upon consummation of the Amended Plan the reorganized B&M will commence business with an unusually low amount of funded debt.

In computing the annual fixed charges of the reorganized B&M, the Commission used the $11.1 million estimate of Mr. Guest for equipment obligations, "rather than the $10,275,000 figure originally presented by the Trustees", (I.C.C. Decision at 20, n.14), and added to that estimate Guilford's loan of $1.5 million to the Trustees for acquisition and rehabilitation of ConRail lines in Massachusetts and Connecticut. Thus the total funded debt used in this computation would amount to $12.6 million. The evidence justified the Commission's use of the increased amount of funded debt, which use was viewed by the Commission as constituting a "conservative approach". Nevertheless, the substantial reduction overall in funded debt that would be effected by consummation of the Amended Plan would result in a decrease of annual fixed charges from approximately $3.07 million in 1981 to no more than $1.3 million after reorganization. The Commission's finding that the Amended Plan adequately provides for coverage of the annual fixed charges of the reorganized B&M by the probable earnings available for the payment thereof is supported by material evidence and comports with correct principles.

The Commission's judgment that B&M's value for purpose of reorganization is about $24,250,000 likewise is supported by material evidence and accords with legal standards. Thus Guilford's cash purchase of the total common equity of the enterprise for $24,250,000 represents an amount which is equivalent to the valuation found by the Commission. *Ecker v. Western Pacific R. Corp.*, *supra* at 483 ("[T]he determination by the Commission of the aggregate amount of securities which may be issued against the system is in substance a finding of total value for reorganization purposes."). It is clear from the record that B&M's value for purpose of reorganization would not support a capitalization which would justify issuance of securities in addition to the new Common Stock purchase by Guilford. The court concludes upon all the evidence that the amount to be paid by Guilford is a fair price for the total issue of 2,425,000 shares of new Common Stock.

The Commission concluded that the provisions of the Amended Plan for distribution of (1) the total of the cash in the Trustees' Restricted Funds Account plus $24,250,000 of cash to be paid by Guilford for the new Common Stock, and (2) the CCIs, as required, to various classes of creditors, are in accordance with the rule of absolute priority. *North Pacific Ry. Co. v. Boyd*, 228 U.S. 482 (1913), and *Case v. Los Angeles Lumber*

*Products Company*, 308 U.S. 106 (1939). Classification of creditors and the order of their priorities were established by orders of the court, entered March 19, 1979 (Order No. 398) and April 19, 1982 (Order No. 637). Order No. 637 provided for a separate classification of general unsecured creditors, and defined their qualifications for membership in the class ("six months" claimants). The Order provided that the priority of the class shall be immediately junior to administration claims and secured tax claims, but senior to all other claims, including those of bondholders. Order No. 637 was entered after the Trustees had filed their plan, and amendments, containing the description of "six months" claims in section 1.19. To the extent that any inconsistency exists between the provisions of section 1.19 and Order No. 637, the court will modify the Amended Plan to conform with Order No. 637 "in order to carry out the plan effectively". (I.C.C. Decision at 60). The Court agrees with the Commission that the distribution of the cash and CCIs under the provisions of the Amended Plan accords with the rule of absolute priority.

In accordance with the request contained in section 3.10 of the Amended Plan, the Commission found that there is no value in the equity of the presently outstanding common and preferred stock of the Debtor. This conclusion follows from (a) the Commission's determination of the value of the reorganized B&M at about $24,250,000, and (b) the fact that the proposed distribution under the Amended Plan of cash and CCIs will be insufficient to satisfy in full the claims of all creditors. Among others, the general unsecured creditors of the Debtor to the full extent of their debts are entitled to priority over the rights of stockholders in the property of the Debtor. *Kansas City Terminal Ry. Co.* v. *Central Union Trust Co.*, 271 U.S. 445, 455 (1926). Furthermore, the Commission determined that the value of the B&M for purpose of reorganization does not justify the issuance of options or warrants to creditors or stockholders to receive, or subscribe for, the new Common Stock of the reorganized B&M. The court is satisfied from the record that the foregoing finding and conclusions of the Commission are supported by material evidence and are in accord with correct principles.

Under Section 77(d) the Commission is charged with the primary responsibility of determining whether the Amended Plan is compatible with the public interest. *Ecker* v. *Western Pacific R. Corp.*, *supra* at 473. In 1967 (almost three years before the petition for reorganization was filed) the Commission recognized the importance of B&M, as a railroad system, "to New England and the national rail system." The Commission has reiterated that recognition in its decision in these proceedings,[20]

thus emphasizing the regional and national importance of the B&M system. Moreover, the Commission has expressly found that the Amended Plan is compatible with the public interest.

In the proceedings before the Commission, all of the states in which the Debtor operates (except Vermont, which took no position on the Amended Plan) gave their support to the Plan. In its consideration of the record before it, the Commission found that the reorganized B&M will *not* be a new system, "having only a speculative prospect for continued life" (I.C.C. Decision at 20, n. 13), but, rather, that Guilford "has evinced an unequivocal commitment to operate B&M for a long term". *Id.* at 19. The Commission noted that "B&M's affiliation with MEC and [Guilford]—which is an integral part of the reorganization—should entail substantial positive benefits for the reorganized entity" (*id.* at 21), and stated that the reorganized B&M "will remain the same railroad presently being operated, with additional traffic and competitive opportunities arising from affiliation with MEC and its recent acquisition of Conrail [*sic*] properties". *Id.* at 20, n. 13.

Thus after reviewing the Commission's findings on (1) the viability of the reorganized B&M, (2) the amount and character of its conservative capitalization, and (3) the reorganized railroad's ability to make appropriate use of B&M's existing facilities and plant to meet the need of the public for an efficient and economical continuing transportation system serving New England and the national rail system, the court agrees that all such findings are adequately supported by the record, are in accord with legal standards and justify the conclusion of the Commission that the Amended Plan is compatible with the public interest.

The findings and conclusions of the Commission demonstrate that, pursuant to Section 77(b)(5), the Amended Plan contains adequate means for its execution. The Amended Plan provides for the transfer of control of the productive operating properties, and other properties, retained by the Debtor, free and clear of all claims of stockholders and, except for $12.6 million of debt, free and clear of all claims of creditors. This transfer of control, under the Amended Plan, will be effected by cancelling all presently outstanding preferred and common stock of the Debtor, pursuant to amendments to be made to the Debtor's charter of incorporation, and by the issuance to Guilford for cash, the total authorized outstanding 2,425,000 shares of new Common Stock of the reorganized B&M. The Amended Plan also provides for the affirmation of the Debtor's leases of the properties of The Northern Railroad, the Stony Brook Railroad, and the Vermont and Massachusetts Railroad, operated in the Debtor's sys-

tem, and the assumption by the reorganized B&M of certain executory contracts. The Amended Plan further provides for the rejection of other executory contracts, and leases.

As further means for its execution, the Amended Plan contains provisions for the distribution of cash and certificates of contingent interest, in accordance with the rule of absolute priority, for the satisfaction of claims of secured and unsecured creditors; and provisions for the satisfaction or elimination of existing liens, or other security, and for the curing of defaults. The Amended Plan also provides (a) for the conversion of Trustees' Certificates into Redeemable Preference Shares, (b) for the transfer of cash from the Segregated Account, in the approximate amount of $6 million, to the reorganized B&M to be used for working capital, and (c) for the discharge of the Debtor from all debts and liabilities to its creditors and stockholders.

The record supports the conclusion of the Commission that the Amended Plan provides adequate means and resources for achieving reorganization of B&M, on a conservatively capitalized basis, as a financially viable operating railroad.

B

The motion of Canadian Pacific Ltd. requesting the court to defer decision on the question of approval of the Amended Plan, certified to the court here by the Commission, until such time as the Court of Appeals for the District of Columbia Circuit has reached a decision on certain petitions for review of the Commission's decision approving the Amended Plan, was denied by Order of the court on November 3, 1982. The Memorandum of the court stating the reasons for the denial was filed with the Order.

Section 77(e) provides that submission of a plan to stockholders is not necessary if their claims have been found worthless by the Commission, "and the judge shall have affirmed the finding". As reported in its decision, the Commission found that the equity of the presently outstanding preferred and common stock of the Debtor has no value. In *Ecker*, the Supreme Court made clear that the requirement of the distict court's affirmation of the Commission's action eliminating claimants having no equity in the debtor's properties "points to a wider scope of review than an inquiry as to whether statutory standards for valuation have been followed". 318 U.S. at 478. Nevertheless, the wider scope of review "does not require an independent appraisal [by the court] of the valuation" found

by the Commission and that "[t]he court properly affirms the Commission, when it finds no legal objection to the Commission's use of its own valuation to determine whether particular claimants are entitled to participate in the reorganization". *Id.* at 479.

The court has found that B&M's value for purpose of reorganization is supported by material evidence and accords with legal standards, and the court has not been made aware of any reason why that finding should be reviewed. In view of the fact that Guilford will pay in cash an amount at least equal to the value of the reorganized B&M for all the authorized outstanding new Common Stock, issuance of additional new Common Stock to the present stockholders in satisfaction of their claims would not be justified. Furthermore, there is no requirement, constitutional or statutory, that stockholders are entitled to "immediately valueless" options or warrants to receive, or subscribe for, securities of a reorganized railroad. *Ecker* v. *Western Pacific R. Corp.*, *supra* at 476. Moreover, as the court has found, the Amended Plan provides for distribution of the value of B&M's assets for purpose of reorganization in accordance with the rule of absolute priority. Thus the court affirms the finding of the Commission that the equity of the present stockholders has no value.

## VI

The opposition to the Amended Plan before the court comes from the following: Providence and Worcester Railroad ("P&W"), CP, group of state and local taxing authorities, a group of Six Months Creditors, the State of New York,[21] the Maine-New Hampshire Interstate Bridge Authority,[22] and two stockholders. The Commission reported in its decision that the principal opposition to the Plan before the Commission came from P&W and CP, that no shareholders nor unsecured creditors appeared to oppose the Plan, and that the other creditors—secured creditors and the holders of priority 'six months claims'—appear satisfied with the plan and do not oppose it". (I.C.C. Decision at 17). The court has considered all objections and claims presented by those who appeared at the hearing, and by those who submitted objections and claims but did not otherwise seek to be heard.

### A

P&W, after the August 11-12, 1982 hearing, filed a brief with the court in which it persists in opposing the Plan. The grounds of opposition are that the Commission disregarded the standard concerning cost of capital

stated in *Chicago, Milwaukee, St. Paul Pacific Railroad Company, Reorganization*, 363 I.C.C. 17 (1980) (*"Milwaukee Road"*); that the Trustees' forecasts of future earnings are grossly overstated; that the reorganized B&M has no prospect of covering its fixed charges; that the Amended Plan does not allow for sufficient working capital; and that approval of the Amended Plan by the Commission violated the provision of the Constitution concerning uniform laws on the subject of bankruptcy. Article I, Section 8 (in the fourth clause) of the United States Constitution. All except the last argument were presented to the Commission which addressed and rejected them.

P&W is not a creditor of B&M, and appears to claim standing to oppose the Amended Plan on the subtle ground that it (P&W) possibly might become a creditor of a reorganized B&M. On the record before the court, the nature of such possibility is not only incalculable, but is too uncertain, indefinite and remote to qualify P&W as a party in interest, within the meaning of Section 77(e), entitled to file objections to the Plan certified by the Commission.

Assuming, *arguendo*, that the objections are properly here, nevertheless they must be found lacking in merit. The main thrusts of the objections are that (1) the Trustees' forecasts are overstated, and (2) even if they are not overstated, the Amended Plan of reorganization is not viable.

The Trustees' expert witness, Isabel H. Benham, concluded that the going concern value of the reorganized B&M is $24,158,000 based on (1) capitalization at 12 percent of the 1982–1985 average of the Trustees' forecasts of net revenues from railroad operations, plus (2) capitalization of income derived from other than rail operations, and (3) additions of asset values not presently producing earnings, with (4) deductions from the total of the foregoing of debt and other ongoing liabilities of the reorganized railroad. (Benham's Verified Statement, Appendix C). Miss Benham explained the earning power component[23] of her valuation of B&M, which she characterized as "an insolvent carrier" in bankruptcy, in her testimony before the Administrative Law Judge. John Guest, financial advisor to Guilford, testified to valuation of the reorganized B&M in the range of $15–18 million. (Com. Ex. C-62).[24] Thomas Dewey, Jr., witness for P&W, testified that he had no opinion of value of the reorganized B&M. (Com. Tr. 774).

Miss Benham's opinion of value was challenged by Dewey as a "gross overstatement" because her capitalization of earnings was based on the Trustees' forecast, which he thought was "spectacularly at variance with

the history in this case". (Com. Tr. 774). (Dewey agreed that he had made no independent analysis of the forecasts.) The record contains evidence that the information which provided the basis of the Trustees' forecasts was obtained by B&M's Marketing and Sales Department directly from B&M's rail customers. The forecasts focused on six major commodity groups that have been, and are expected to be, the backbone of B&M's freight business, and the probable market opportunities and traffic levels through 1985. Miss Benham made a detailed analysis of the projections and their bases, as shown in Appendix D of her Verified Statement. Her view of the commodity mix overall is that it was "lackluster", but she concluded that "every effort has been made to make the projections as conservative as possible". She was of the opinion that the projections for 1982 may not be reached, "but we would expect 1985 tonnage results to be fairly close to the targets with the possibility of revenues substantially exceeding the forecasts". (Appendix D at 7). She affirmed this belief later in testimony that "in the five year period [the tonnage forecasts] will come out probably exactly where they say they are," and noted that B&M's downturn in 1981 car loadings was no different than that of the industry as a whole. She stated that B&M's tonnage and revenues are projected to grow at a compound annual rate of 1.5 percent and 1.2 percent, respectively, while operating expenses are estimated to increase at the rate of 0.6 percent, compounded annually. She found the Trustees' estimated cash flows adequate to cover annual debt maturities and capital expenditures, and she observed that "a high level of cash inflows over cash outflows are [*sic*] more indicative of . . . viability and financial strength than reported earnings or other yardsticks . . .". (Benham's Verified Statement at 13). According to Miss Benham, although coverage of fixed charges is "more than adequate", the margin of safety ratio for such charges is slim, suggesting "that revenues . . . may be inadequate in relation to the cost of handling the traffic". *Id.* at 16–17. It was her view that "if the earnings and cash projections . . . should not be realized . . ., the conservative capitalization of the reorganized company suggests that external funding of capital requirements would be possible without jeopardizing the ICC fixed charge coverage yardstick of 3.5x". She concluded that:

> the Trustees' projections are conservative and that, if revenue forecasts turn out to be too optimistic, there is room in the expense accounts to compensate for any revenue decline because of the major rehabilitation programs projected to be charged to those accounts.

> Most important, the cash flow projections indicate that adequate debt protection exists and that sufficient sums will be generated internally to meet capital requirements over the first four years after consummation of the Plan.

*Id.* at 16–17.

John Guest gave testimony in support of the Amended Plan and the viability of B&M and Maine Central Railroad ("MEC") as components of Guilford's system. He contrasted B&M's ten years of deficits during 1970–1979 with the recent benefits to B&M brought about by the Trustees in management, advantageous commuter service contracts, rehabilitation of the main line, and relief from burdensome work rules in labor relations; and he noted that, absent the coal strike and expenditures for excessive maintenance, B&M would have reported net revenue from railway operations ("NRRO") of approximately $1.0 million in 1981. He observed that under the Amended Plan B&M will emerge from bankruptcy with a $12.6 million debt; "an unusually low amount of funded debt", and that his *pro forma* statements of income and cash flow, based on alternative assumptions of (a) NRRO at $2.5 million a year and (b) NRRO at $4.7 million a year (reflecting B&M's share of benefits from Guilford's common control of B&M and MEC), indicate that under normal economic conditions B&M should enjoy positive net income, and demonstrate both a satisfactory fixed charge coverage ratio and a high ratio of gross cash flow to total debt. He noted that in assessing viability of an enterprise it is necessary to consider both good years and bad years, and that "unusual adverse events such as the impact of a coal strike may appropriately be excluded . . .". Turning to the feasibility of the Amended Plan, Guest concluded that the effect of the recession on B&M's recovery progress did not appear to daunt Mr. Mellon, who "testified . . . that Guilford viewed B&M as a long range investment and [that he] continued to support the Trustees' plan, including the payment of $24,250,000 for the entire [issued] common stock of the reorganized railroad". (Guest's Verified Statement at 9).

Material evidence was presented to the Commission concerning the value of the reorganized B&M. It is true that in 1981 and 1982 earnings of the Debtor fell short of earnings predicted for those years by the Trustees, but, as the Commission found, the shortfall resulted in large part from unusual adverse conditions arising out of the continuing economic recession coupled with a coal strike and expenditures for excessive maintenance. There was adequate evidence to support these findings, and the

weight to be accorded to the conditions referred to, and the conclusions reached, by the Commission are not subject to reexamination here. Moreover, there was additional evidence of factors relevant to future earning power of the reorganized B&M in the record before the Commission; thus the Commission was not bound to agree with P&W's argument that the Trustees' forecasts for 1982 through 1985 like a "house of cards must now come tumbling down". Nor was the Commission bound to accept P&W's estimate of the yield from B&M's contract with MBTA, or the adverse impact on B&M's revenues which P&W assumed would result from the Norfolk and Western-Southern ("NS") consolidation. The thrust of these arguments is not that the record was lacking in evidence to support the Commission's findings and conclusions; rather, it is that the Commission should have found facts as P&W preferred them to be.

It was for the Commission in the exercise of its fact-finding function, in considering evidence which arguably might have tended toward alternative conclusions, to determine future earning capacity of the reorganized B&M, its coverage of fixed charges, and the question of adequacy of its working capital. The findings and conclusions reached by the Commission lie within the limits of the evidence in the record, and the court, in reviewing the Commission's findings and conclusions, can see no reason to interfere with the discretion confided to the Commission to determine whether the evidence before it affords a reliable basis for its conclusions.

P&W contends further in its brief filed here that under the test stated in the Commission's decision in *Milwaukee Road* the reorganized B&M will not achieve, under the Trustees' forecasts, a rate of return equivalent to the railroad industry's cost of capital. P&W argues that such rate of return is a condition of approval of the Amended Plan.

In addressing this argument, the Commission stated:

> The Trustees have established requisite viability of the reorganized B&M on the basis of its realistic earning potential. *Milwaukee Road* did not establish an absolute requirement that a reorganized railroad achieve a rate of return on total capitalization greater than the railroad industry cost of capital. Indeed, in *Milwaukee Road* we expressly refused "to develop a rate of return which would signify viability . . . [ellipsis in text] since the rate could vary depending on the capital sources available to the system, the risk of the proposal, and the magnitude of public involvement." *Id.* at 48. We focused on the "hurdle" rate that would induce an investor to make the "new

investment" in a "newly reorganized railroad." *Id.* at 49. And we noted that one of the principal reasons for ensuring that a reorganized carrier can achieve an adequate rate of return is that in the absence of such a return, it "would have great difficulty attracting outside capital, and would have a strong disincentive from reinvesting its own funds in the system." *Id.* at 45.

In this case the ultimate test of viability established in *Milwaukee Road* has already been met. In contrast to the involuntary investment in a reorganized railroad which shareholders of its non-railroad holding company were required to make under both of the Milwaukee Railroad reorganization plans, here an outside source of private capital—[Guilford]—has agreed to invest $24.25 million to acquire the reorganized railroad. P&W and CP argue, in essence, that we should not permit this investment because it might not prove profitable for [Guilford]. We believe that a clear indication of profitability and of long term viability is the willingness of private investors to place their funds at risk in an enterprise. Approval of the Amended Plan is wholly consistent with *Milwaukee Road*. [Footnote omitted].

(I.C.C. Decision at 19–20).

A detailed narrative of the extensive rehabilitation of track and equipment problems of *Milwaukee Road*, and its traffic and financial hurdles, which required the attention of the Commission and results in the rejection by a unanimous Commission of two plans of reorganization and a plan of liquidation, is set forth in the 53-page decision in 363 I.C.C. 17 (1980). The court has examined all phases of that decision carefully, particularly the discussion of conditions establishing viability; it will serve no useful purpose here to enter upon a detailed dissertation on *Milwaukee Road*.[25] *Milwaukee Road* and B&M, as candidates for Commission approval of reorganization under Section 77, have little, if anything in common as to their overall problems, and their respective proposals for providing means for the continued operation of manifestly disparate railroad systems. The Commission itself recognized important distinctions between the plan of reorganization in *Milwaukee Road* and that in B&M. and therefore the Commission, in its unanimous decision approving the B&M Trustees' Amended Plan, could and did conclude that: "[a]pproval of the [B&M] Amended Plan is wholly consistent with Milwaukee Road". *Id.* at 20. The court finds no basis for disagreement with that conclusion.

P&W's objection predicated on *Milwaukee Road* and *Railway Labor*

*Executives' Assn.* v. *Gibbons*, 102 S. Ct. 1169, *rehearing denied*, 102 S. Ct. 1997 (1982) ("RLEA"), is entirely without merit. In the first place, the Commission's decision approving the Amended Plan proposed for B&M is not shown to be inconsistent, either in principle or in respect to any material fact, with the Commission's decision in *Milwaukee Road*. Moreover, no question as to the uniformity requirement of Article I, Section 8 (in the fourth clause) of the United States Constitution[26] arises when the Commission's decisions in *Milwaukee Road* and B&M are compared. Neither the uniformity clause of the Constitution nor the decision in *RLEA* constrains the Commission in the exercise of its statutory function when resolving the question whether a plan of reorganization should be approved.

After reviewing the objections of P&W, which, as above noted, the court assumed for the sake of argument were properly here, the court concludes that the objections should be and are hereby overruled and denied.

B

Various state and local taxing authorities object that the Amended Plan makes no allowance for payment of interest on unpaid tax-lien claims up to the date of payment.

Claims for unpaid taxes constituting liens against the property of the Debtor, accrued before the petition for reorganization was filed, amount to approximately $640,000. The Amended Plan provides for payment in cash in the full amount of the principal of these claims, and the Trustees concede that interest thereon which accrued to the time of filing the petition on March 12, 1970 is payable on the claims. The plan will be modified to provide for such payment of interest. The objections of taxing authorities who seek postpetition interest on the prepetition secured taxes will be discussed hereafter.

Claims for unpaid taxes likewise constituting liens, accrued during reorganization (March 12, 1970 through June 30, 1982), amount to $7.6 million. The Amended Plan provides for payment in cash in the full amount of these claims due and owing as of the date of consummation. The Trustees contend that no interest should be paid on these tax claims.

The question whether the Plan should provide for the payment of interest on unpaid taxes was not raised before the Commission; the question was raised before the court by numerous taxing authorities. At the court's suggestion the Trustees filed a petition seeking a determination as to the

liability of the Debtor's estate for payment of interest on tax claims, and, after notice to all parties in interest, the court heard the petition on August 5, 1982. A motion was allowed by the court that the proceedings on the petition be incorporated in the record of the hearing on the question of approval of the Amended Plan.

The evidence in the record establishes that during the period of reorganization sufficient cash has not been available to pay current taxes and all necessary current operating expenses indispensable to continued rail operation. Generally, postpetition local taxes are regarded as part of the cost of doing business in reorganization, but circumstances may arise when deferment by the court of tax payments is authorized. *See In re Penn Central Transportation Co.*, 325 F. Supp. 294 (E.D. Pa. 1970), *affirmed*, 452 F.2d 1107 (3rd Cir. 1971). In determining what allocation should be made of cash in the Debtor's estate, when the amount of such cash proves insufficient to meet all current obligations, paramount consideration must be given to the public interest in the continued operation of the railroad system in the cities and towns it serves. Here, payment of the taxes accrued during the reorganization was deferred by order of the court, to keep the railroad in operation, and the delay in making prompt payment of the tax obligations must be viewed as "a delay necessitated by law if the courts are properly to preserve and protect the estate for the benefit of all interests involved . . .". *Vanston Bondholders Protective Com.* v. *Green*, 329 U.S. 156, 163 (1946).

It has been a long-standing rule in bankruptcy and equity receiverships that accumulation of interest upon claims against the debtor stops when the petition is filed with the court. *Nicholas* v. *United States*, 384 U.S. 678 (1966); *City of New York* v. *Saper*, 336 U.S. 328 (1949); *Vanston Bondholders Protective Com.* v. *Green*, *supra*; *Sexton* v. *Dreyfus*, 219 U.S. 339 (1911); *Thomas* v. *Western Car Company*, 149 U.S. 95 (1893). *See United States* v. *Harrington*, 269 F.2d 719 (4th Cir. 1959). In *City of New York* v. *Saper*, *supra*, the rule was made applicable to the accumulation of interest on tax obligations. *See Nicholas* v. *United States*, *supra* at 662 & n.10. The reasons advanced for the rule are that the time the petition is filed "fixed the moment when the affairs of the bankrupt are supposed to be wound up", *Sexton* v. *Dreyfus*, *supra* at 344, and that "creditors should not be disadvantaged *vis-a-vis* one another by legal delays attributable solely to the time-consuming procedures inherent in the administration of the bankruptcy laws" [footnote omitted]. *Nicholas* v. *United States*, *supra* at 683.[27]

The City of Cambridge (Cambridge) has the largest claim for unpaid postpetition tax liens (an amount now probably in excess of $3.5 million), and Cambridge contends that the Debtor will have sufficient resources "to pay all creditors in cash when the plan is confirmed, even if interest [probably in excess of $1.9 million in statutory interest] is allowed on [Cambridge's] tax claims". In light of the record in these proceedings on the question of approval of the Amended Plan, the court is not persuaded that Cambridge's vision of the future—full payment in cash to all creditors—is likely to be fulfilled. However, if it should come to pass, after all claims have been paid in full in cash, that there remains in the hands of the Debtor a surplus over and above what is required for the execution of the Amended Plan, then, in the view of the court, equitable considerations might permit payment of postpetition interest on such unpaid tax-lien claims of state and local taxing authorities. *Vanston Bondholders Protective Com.* v. *Green*, *supra* at 164.

Cambridge further contends that it is entitled to receive interest on its postpetition secured tax claims before interest is allowed to the holders of the First Mortgage bonds and the Income bonds. To support its contention, Cambridge asserts that it relies upon the absolute priority rule of *North Pacific Ry. Co.* v. *Boyd*, *supra*, and *Case* v. *Los Angeles Lumber Products Company*, *supra*. Cambridge argues that by allowing interest to the bondholders, whose claims are at a lower priority, while denying allowance of interest on postpetition secured tax claims, the Amended Plan violates the absolute priority rule. The court disagrees.

Even though the Amended Plan provides for allowance of interest according to the terms of the bonds secured by the First Mortgage Indenture and the General Income Mortgage Indenture,[28] while it makes no allowance of interest on postpetition secured tax claims, the Plan is not objectionable. *In re New York, New Haven and Hartford Railroad Co.*, 304 F. Supp. 1121, 1133–34 (1969). *See United States* v. *Harrington*, *supra* at 724, and *State of New York* v. *Feinberg*, 204 F.2d 502, 503 (2d Cir. 1953). *In Harrington*, *supra*, the court succinctly stated the rationale for the distinction drawn between mortgagees and secured tax claims in the allowance of postpetition interest: "The justification for this allowance to mortgagees, etc., would seem to be that when the creditor extended credit, he relied upon the particular security given as collateral to secure both the principal of the debt and interest until payment and, if the collateral is sufficient to pay him, the contract between the parties ought not be abrogated by bankruptcy. This rationale has no application to tax liens." *Id.* at 724. There is nothing in *Fosdick* v. *Schall*, 99 U.S.

235 (1879), or *In re Boston and Maine Corporation*, 634 F.2d 1359 (1st. Cir. 1980), *cert. denied*, 450 U.S. 982 (1981), or *Southern Railway Company* v. *United States*, 306 F.2d 119 (5th Cir. 1962), relied upon by Cambridge, inconsistent with denying interest on secured tax claims while allowing payment of interest according to the terms of the mortgage bonds. The court finds that the Amended Plan does not violate the absolute priority rule in denying allowance of interest on postpetition secured tax claims.

*Vanston* counseled that "the touchstone of each decision on allowance of interest in . . . reorganization has been a balance of equities between creditor and creditor or between creditors and the debtor." 329 U.S. at 165. Should postpetition interest be allowed on either prepetition or postpetition secured tax claims here, until payment of the principal, the delay in making prompt payment of the taxes—a delay necessitated by law to keep the railroad running—would diminish the distributive shares of general creditors through no fault of theirs, and would have the effect of penalizing them. Under such circumstances, allowance of postpetition interest claimed by the taxing authorities here would not be in accord with equitable principles. *Vanston*, *supra* at 163-65; *United States* v. *Harrington*, *supra* at 721-24.

While postpetition secured taxes are part of the cost of doing business during the reorganization, and, accordingly, are entitled to the same priority as administration expenses, such taxes do not enjoy a higher rank over other administration expenses. Presumptively, all administration creditors should be treated alike. In any event, the fact that postpetition secured tax claimants are entitled to the priority of administration creditors, does not entitle them to allowance of interest until paid.

The provisions of the Amended Plan are not objectionable for failure to make allowance for payment of postpetition interest, to date of payment, on either prepetition taxes or postpetition taxes. *In re New York, New Haven and Hartford Railroad Co.*, *supra* at 1134; *In re Penn Central Transportation Co.*, *supra* at 298ff.

The Town of Madbury, New Hampshire ("Madbury") filed an objection to the Amended Plan for failure of the Plan to make allowance of postpetition interest to date of payment of its tax-lien claim. Madbury points to the undisputed facts, apparently distinctive to its claim, that the real estate that secured its tax lien was sold in 1974 for a price well above the assessed value, and that since 1974 the Debtor has had the benefit of the substantial interest income on these proceeds. On the basis of these facts, Madbury argues that the court should exercise its equitable discre-

tion to allow Madbury's interest claim, even if the court does not allow the outstanding postpetition interest claims of other taxing authorities.

The City of Keene, New Hampshire ("Keene") filed objection to the Amended Plan for failure of the Plan to allow interest on its tax claim. Keene also calls attention to circumstances, which it asserts are peculiar to its claim, that warrant exercise of the equitable discretion of the court to allow postpetition interest on Keene's unpaid taxes. Keene asserts that although the Debtor has owned real estate in Keene, some of which was used in the ordinary business of the railroad and some of which was not, during the reorganization period, Keene has received "nothing but decreasing railroad service" from the Debtor. Therefore, Keene argues, the court should view the distinctive equities in Keene's claim as weighing in the balance in Keene's favor.

After a careful review of the undisputed facts, and the assertions and arguments advanced by Madbury and Keene, respectively, the court finds that the delay in making prompt payment of their tax claims was "necessitated by law" to keep the railroad running. While the circumstances and details of Madbury's and Keene's claims distinguish their claims somewhat from the interest claims of others, nevertheless, in the "balance of equities between creditor and creditor" it would not be equitable for either Madbury or Keene to gain an advantage over others because of the act of the law in the delay in distribution of the assets of the Debtor's estate to all entitled to them under the Amended Plan.

After review of the objections filed by the taxing authorities, the court concludes that the Amended Plan providing (1) payment in cash in the full amount of prepetition secured taxes, and interest thereon from the date of default until March 12, 1970, at the rate of interest payable during the period of default, (2) payment in cash in the full amount of postpetition taxes, and (3) no payment of postpetition interest to date of payment of the tax on either prepetition taxes or postpetition taxes, is not objectionable. The court concludes further that the objections should be and are hereby overruled and denied.

C

Certain holders of unsecured claims, who assert entitlement to priority under the Six Months rule, have objected to the Amended Plan for its failure to provide for allowance of interest on their prepetition claims. The group of claimants raising the objection includes the Chessie system,[29] CP, Penn Central, and the Committee on Interline Railroads. In

seeking allowance of interest, these claimants rely on Order No. 637 of the court and on the decision in *In re Boston and Maine Corporation, Debtor, supra.* Furthermore, the claimants argue that standards of fairness and equity require that the Amended Plan provide for allowance of interest on their claims.

As mentioned above at 26, Order No. 637 established a separate classification of general unsecured creditors. Pursuant to Section 77(b) [11 U.S.C. §205(b)][30] of the Bankruptcy Act, and in accordance with the principles in *In re Boston and Maine Corporation, Debtor, supra*, Order No. 637 provides as follows:

> The holders of general unsecured claims against the Debtor, timely filed and duly proved in this matter and allowed by the court, where each claim meets these requirements: (a) it was incurred within six months before the filing of the petition for reorganization on March 12, 1970, (b) it was for an expense necessarily incurred for the purchase of goods or services used in the current operations of the railroad, and (c) the goods or services were delivered on credit in the expectation they would be paid for out of current operating revenues of the railroad and not in reliance on the railroad's general credit.
>
> Payment of claims of this class shall be on the same basis and from the same operating income as administration claims of operating expense creditors.

As appears above at 16, the principal amount of each allowed Six Months claim will be paid in full in cash on the Consummation Date.

It is clear that neither Order No. 637 nor the decision of the First Circuit in *Boston and Maine, supra,* supports the interest claims. The question of entitlement to interest was not considered by the Court of Appeals, nor was it considered by this court. Allowance of interest does not necessarily accrue to unsecured claims that qualify for the Sixth Months priority. The general rule against accumulation of interest upon claims against the debtor after the filing of the petition is applicable to Six Months claims, and no showing has been made that these claims fall within any of the exceptions to the rule. The court concludes that as general unsecured creditors, the holders of Six Months claims are not entitled to postpetition interest.

The Six Months claimants also assert entitlement to interest that accrued on these underlying claims before the petition was filed on March 12, 1970. In *Debentureholders, Etc.* v. *Continential Inv. Corp.*, 679 F.2d 264, 268 (1st Cir. 1982), *cert. denied*, 103 S. Ct. 165 (1983), the court

pointed out that "[p]re-petition interest is governed by state law, absent an overruling federal law". *Cf. Vanston Bondholders Protective Com.* v. *Green, supra* at 161–70. The applicable law in Massachusetts was summarized in *Debentureholders, supra:*

> State law may allow pre-petition interest either because the parties have so contracted or because under state rules governing contracts a person who breaks a contract for a liquidated sum must pay as part of the damages interest from the date of the breach. [Citations omitted.]

679 F.2d at 268. None of the Six Months creditors claiming prepetition interest here has presented evidence, or has argued, that the claim for interest arises out of the terms of a contract providing for payment of interest. Nor has there been any showing made of a basis in "overruling federal law" that would support allowance of prepetition interest claims.

The court is not persuaded that considerations of fairness and equity support the allowance of interest on these claims. "A reorganization court must consider the issue of postpetition interest not in the abstract, but in light of the nature of each claim, and in application of basic principles of fairness and equity." *In re Penn Central Transportation Company,* 358 F. Supp. 154, 170 (E.D. Pa. 1973). It must not be overlooked here that under the Amended Plan each Six Months creditor will receive in cash the full amount of principal of his allowed prepetition unsecured claim while all other general unsecured creditors will receive only Series D CCIs equal to ten pecent of their respective liquidated and allowed claims. Moreover, under the Amended Plan these Series D CCIs will be redeemed in cash *only* if and when cash is determined to be available in accordance with section 3.1(2) of the Plan, as amended. To allow interest on the claims of the Six Months creditors until payment of the principal would be to penalize other creditors because of a delay necessitated by law. *Cf. United States* v. *Harrington, supra* at 723, and *Vanston Bondholders Protective Com.* v. *Green, supra* at 163. The allowance of interest under such circumstances would not be in accord with equitable principles.

The court concludes that the objections of the Six Months creditors to the Amended Plan for failure to provide allowance of postpetition interest on the allowed claims should be and are hereby overruled and denied.

D

Written objections to the Amended Plan were filed by two stockholders—one holding shares of the presently outstanding common stock; the

other holding shares of both outstanding preferred and outstanding common stock—who seek equitable treatment for failure of the Plan to make provision for a distribution to them of part of the Debtor's assets. As explained earlier in this opinion, the Commission found that the equity in the shares of the preferred and common stock has no value, and the court has affirmed that finding. As a general proposition, a plan of reorganization cannot provide for a stockholder's participation in the reorganization unless the plan provides full compensation to unsecured creditors for their rights discharged pursuant to the plan. Although the result is unfortunate, the court must reaffirm here the Commission's finding in view of the value of the Debtor's property for purpose of reorganization and the application of the absolute priority rule. The court concludes that the objections of the two stockholders should be and are hereby overruled and denied.

VII

Under the Commission's order approving the Amended Plan and certifying it to the court, it is stated that "[t]he construction of the Amended Plan by the court, whether before or after the submission of it to creditors, is final and conclusive. The court shall have the power to cure any defect, supply any omission, or reconcile any inconsistency in such manner and to such extent as may be necessary or expedient in order to carry out the plan effectively." (I.C.C. Decision at 60). For the purpose of clarifying and making effective the provisions of the Amended Plan, the following modifications of the Amended Plan, which will not require its reference to the Commission, should be made:

A. The sentence in section 4.3 of the Amended Plan ("Rejection of . . . Executory Contracts") shall be modified by striking out the period at the end of the sentence, and by substituting therefor a comma, and by adding to the sentence the following: "and the Trustees shall give notice to each party to a contract to be rejected of such rejection by mailing notice of such action pursuant to the order of the court."

B. The sentence in section 3.11 of the Amended Plan ("Issuance of New Common Stock") shall be modified to read as follows: "As of the Consummation Date, the First Mortgage Bonds and the Income Bonds registered in the name of Guilford pursuant to sections 3.4 and 3.5 above shall be transferred to the Trustees, and the bonds shall thereupon be cancelled by the Trustees, and

the reorganized Company shall issue to Guilford, and Guilford shall become the sole owner of 2,425,000 shares of Common Stock, which shares shall constitute all of the outstanding Common Stock of the Reorganized Company."

C. The part of the sentence in section 3.3(1) ("Segregated Account"), commencing in subsection (ii), shall be modified by adding at the end of subsection (ii) the following: "such amount of cash or cash equivalents of the Debtor in Account No. 703 ("Special Deposits"), as of the Consummation Date, as represents the proceeds of the Reading Line Interest Settlement, and"

D. The last sentence in section 2.2 of the Amended Plan, commencing "Effective as of the Consummation Date", shall be modified to read as follows: "Effective as of the Consummation Date, the reorganized Company shall thereupon and thereafter be responsible for all Administration Claims, if any, which are not satisfied in full prior to the Consummation Date, and the Trustees shall have no further responsibility relating to the Debtor or to the conduct of its affairs; provided, however, that the Trustees shall continue to serve as such for the limited purposes of administering and making payments from the Segregated Account, as provided in Article III below, and implementing the New Plan, as provided in section 4.4 below; and provided further that any compensation payable to the Trustees for such services after the Consummation Date shall be in such amounts as the Reorganization Court may approve as being appropriate and shall be paid solely from the Segregated Account."

The court determines that it is necessary to clarify the provisions of section 4.3, relating to the rejection of executory contracts, because the section, as it read before the modification, appeared to authorize rejection of executory contracts without notice of such rejection to the other contracting party. The modification makes it clear that such notice is required by the Amended Plan.

The principal purpose for modifying section 3.11 of the Amended Plan is to provide for cancellation of the First Mortgage Bonds and the Income Bonds after payment to the bondholders has been effected pursuant to sections 3.4, 3.5 and 3.7 of the Amended Plan. Although section 4.5 of the Amended Plan is entitled "Cancellation of Securities, Etc.", no provision is made therein, or elsewhere in the Amended Plan, for cancella-

tion of either the First Mortgage Bonds or the Income Bonds. It is clear that the Amended Plan considered as a whole contemplates that the First Mortgage Bonds and the Income Bonds shall be paid in full on the Consummation Date, and that the Debtor's liability thereon shall be discharged. Explicit provisions requiring cancellation of the bonds by the Trustees on the Consummation Date will confirm that construction of the Plan.

On October 13, 1982 the court determined that the $2.0 million paid by MBTA to the Trustees in settlement of the Debtor's claim for interest on an arbitration award in favor of the Debtor, arising out of the Reading Line Taking, so called, were not restricted funds in the hands of the Trustees. It was the court's opinion that those "funds and all increments thereto should be held by the Trustees pending further action on the Amended Plan". The foregoing rulings appear in the court's Memorandum filed October 13. The modification of section 3.3(1) makes clear that the proceeds of the Reading Line Interest Settlement should no longer be held by the Trustees as restricted funds, but should be held for deposit in the Segregated Account.

The court determines that it is necessary to clarify the provisions of section 2.2, by striking certain language therefrom, in order to avoid possible conflict with sections 4.4 ("Implementation of New Plan") and 4.6 ("Reservation of Jurisdiction") concerning the powers, duties and immunities of the Trustees on the Consummation Date and thereafter. In the court's opinion, such powers, duties and immunities of the Trustees will be more appropriately defined and described in the Consummation Order.

Upon full consideration of the record of proceedings before the Commission on the Amended Plan, including the verified statements of witnesses, the transcripts of testimony, and the proceedings before the court, the court is satisfied that the relevant findings and conclusions of the Commission on the Amended Plan as certified to the court, are adequately supported by material evidence and agree with legal standards.

Further, the court is satisfied that the Amended Plan, as modified

(a) complies with the provisions of Section 77(b), and (e) as amended, of the Bankruptcy Act [11 U.S.C. §205(b) and (e)];

(b) is fair and equitable and affords due recognition to the rights of each class of creditors and stockholders;

(c) does not discriminate unfairly in favor of any class of creditors or stockholders, and will conform to the requirements of the law

of the land regarding the participation of the various classes of creditors and stockholders;

(d) makes adequate provision for payment of all costs of administration and all other allowances made or to be made by the court;

(e) makes adequate provision for payment of expenses and allowances incident to the reorganization, including compensation and reimbursement of expenses, within such maximum limits as are fixed by the Commission to be subject to the approval of the court, as provided in Section 77(c)(12) [11 U.S.C. §205(c)(12)] (the amount reserved in the Amended Plan for all such purposes is in excess of the total amount of claims for payment which can reasonably be anticipated);

(f) is feasible, and is compatible with the public interest.

To summarize briefly, the court concludes that all of the statutory prerequisites to approval have been met, and that the Amended Plan, as modified for the purpose of clarifying and making effective its provisions, will be approved. Furthermore, all objections to the Amended Plan are hereby overruled, and all fees and expenses within such maximum limits as are fixed by the Commission subject to the approval of the court will be ordered paid.

VIII

The B&M was a comparatively small railroad when the petition for reorganization was filed. At that time the railroad was badly run down and in need of substantial capital investment and improvement. From the inception of reorganization the Trustees have made good progress in cutting costs, restoring the level of service on the railroad, retaining the confidence of its customers, and progress toward reorganization. The Trustees, their counsel, B&M management and employees, all have devoted many years of hard work to the struggle to achieve reorganization, and much credit is due to them for bending their efforts and skills toward reaching that goal. Much credit is also due to other parties, with vital interests in the Debtor's estate, for their patient cooperation during the reorganization process. The B&M still is a comparatively small railroad, but manifestly a much healthier one.

Accordingly, in consideration of the foregoing, it is hereby *ORDERED:*

(1) The Amended Plan as modified is hereby *Approved.*

(2) The final date for mailing written acceptances or rejections of the Amended Plan is March 30, 1983.

(3) Voting on the Amended Plan shall be governed by the provisions of the Voting Procedure on Plan of Reorganization, Order No. 709, entered this date.

(4) A certified copy of this opinion and order shall be sent to the Commission.

February 23, 1983

Senior District Judge

## FOOTNOTES

1. *Boston and Maine Corporation—Amended Plan of Reorganization*, I.C.C. Finance Docket No. 26115 (Sub-No. 12), and *Guilford Transportation Industries, Inc.—Control—Boston and Maine Corporation*, I.C.C. Finance Docket No. 29720 (Sub-No. 1), Decided Apr. 23, 1982 ("I.C.C. Decision").

2. Section 77(e) of the former Bankruptcy Act [11 U.S.C. §250(e)] in the sixth sentence provides that:

   > If the judge shall approve the plan, he shall file an opinion, stating his conclusions and the reasons therefor, and enter an order to that effect, and shall send a certified copy of such opinion and order to the Commission.

3. The Equitable Life Assurance Society of the United States, Metropolitan Life Insurance Company, Connecticut Mutual Life Insurance Company, and the Northwestern Mutual Life Insurance Company, holders of First Mortgage bonds of B&M in the aggregate principal amount of $14,198,000, or about 30 percent of such bonds outstanding.

4. *Boston and Maine Reorganization*, I.C.C. Finance Docket No. 26115, Report and Order Recommended by Victor A. von Rinteln, Adm. Law Judge, Feb. 2, 1973, at 25.

5. The assignment of this reorganization case in the first instance was drawn by the late District Court Judge Francis J.W. Ford, who appointed the three Trustees. Mr. Cherington resigned as Trustee as of December 21, 1971, and Mr. Bartlett resigned as of January 9, 1973. Upon reassignment, the case was drawn by the author of this opinion on November 9, 1973.

6. *See* n.4, *supra* at 35.

7. Before this plan was filed in 1975, the court was required, within 120 days following January 2, 1974, to determine under the general provisions of Section 207(b) of the Regional Rail Reorganization Act of 1973, Pub. L. No. 93-236, 87 Stat. 985, whether B&M should continue under the reorganization provisions of Section 77 of the former Bankruptcy Act (11 U.S.C. §205) or be subject to reorganization under the Regional Rail Reorganization Act. This court held on May 2, 1974 that the public interest would be better served by continuing B&M under the present reorganization proceedings. *In re Boston and Maine Corporation*, 378 F. Supp. 68 (D. Mass. 1974).

8. Guilford Transportation Industries, Inc. was organized as a corporation under the laws of Delaware in 1981. Timothy Mellon is the owner of all or substantially all of the common stock of Guilford, which is owner and holder of all of the outstanding stock of Maine Central Railroad Company ("MEC") and in control of MEC. Guilford recently has acquired conditionally all of the outstanding common stock of Delaware & Hudson Railroad ("D&H"). Guilford is a holding company with substantial investments in railroad properties which it controls and proposes to manage.

9. Order No. 629 specifically authorized the Trustees to purchase certain lines, amounting to approximately 164.5 miles of track, which serve the following towns and cities (a) in Massachusetts: Pittsfield, North Adams, North Adams Junction, and Springfield; and (b) in Connecticut: Canaan, Hazardville, Plainville, Avon, Waterbury, Hartford, New Haven, Bloomfield, Wethersfield, Berlin, New Britain, Highland Junction, Watertown, and Torrington. One such line, that between Waterbury and Torrington, was, however, subsequently conveyed to the State of Connecticut. Order No. 629 also authorized the Trustees to obtain trackage and/or oper-

ating and reciprocal switching rights over certain lines and in a rail yard which serve or are located in the following towns and cities (a) in Massachusetts: North Adams Junction, Pittsfield, and Springfield; and (b) in Connecticut: Hazardville, Bloomfield, Griffins, New Haven, Waterbury, Derby, Wethersfield, Rocky Hill, and Hartford. The expansion of operations contemplated in Order No. 629 afforded B&M opportunities, *inter alia*, to develop connections and cooperation with the Long Island Rail Road. Nevertheless, it is important to note, in this regard, that the Commission, in reaching its decision to approve the Trustees' Amended Plan, did not, when calculating revenues of B&M, "include income associated with these acquisitions" of lines in Massachusetts and Connecticut. *See* I.C.C. Decision at 22, n.d.

10. Additional designations, preferences, rights, qualifications and limitations concerning the Redeemable Preference Shares are set forth in Exhibit I of the Amended Plan.

11. *See In re Tennessee Central Railway Company*, 463 F.2d 73 (6th Cir.), *rehearing en banc denied, cert. denied*, 409 U.S. 893, *rehearing denied*, 409 U.S. 1029 (1972).

12. The Amended Plan calls for the establishment of the Segregated Account in section 3.3 which provides, in relevant part, that:

    Cash from the following sources shall be deposited in the Segregated Account as follows:

    (i) proceeds of the so-called Boston Garden Mortgage presently held by the Trustee for the First Mortgage Bonds and all cash, certificates of deposit and other cash equivalents on deposit as of the Consummation Date with approved depositories in restricted accounts, including proceeds of other sales or condemnations of property between the date of this New Plan and the Consummation Date shall be deposited in the Segregated Account as of the Consummation Date; provided, however, that if the remaining proceeds of the Concord-to-Lincoln taking by the State of New Hampshire in 1975 (in the amount of approximately $427,000) or the proceeds of the Somerville taking of 1967 are received subsequent to the Consummation Date, such proceeds, less the expenses of prosecuting and settling such takings, shall be deposited in the Segregated Account at such time as they are received; and provided further that any proceeds in excess of $500,000 in the aggregate from any sales or condemnations of property (other than the Concord-to-Lincoln and Somerville takings referred to above and other than the sales specifically described in Part 2 of Schedule E of the Acquisition Agreement) between the date of this New Plan and the Consummation Date shall be paid to the reorganized Company, shall not be deposited in the Segregated Account and shall be excluded in computing the balance in Accounts No. 701 and 702 in accordance with clause First of Subsection (2) of this Section 3.3;

    (ii) such amount, if any, of cash or cash equivalents of the Debtor in Accounts Nos. 701 and 702 as of the Consummation Date or December 31, 1981, whichever shall occur first, as is in excess of $5,250,000 shall be deposited in the Segregated Account as of the Consummation Date; provided, however, that such excess amount, if any, shall be deposited in a restricted account as of December 31, 1981, if the Consummation Date has not occurred; and

    (iii) cash in the amount of $24,250,000 to be provided by Guilford pursuant to the Acquisition Agreement shall be deposited in the Segregated Account as of the Consummation Date.

Cash in the Segregated Account shall be invested to the extent practicable as permitted by Rule 8-505 of the Bankruptcy Rules.

13. The Trustees' certificates of indebtedness in the amount of $26,000,000 will, under the Plan, be exchanged for the 2600 Redeemable Preference Shares, as noted above, and, consequently, are excluded in the list of claims here.

14. The net balance of funds on deposit on June 30, 1982, in these three accounts totals $6,610,098.

15. In their reponse filed August 11, 1982 to the court's Order No. 675, the Trustees estimate that the amount of available cash for distribution to creditors will probably be $75.5 million at the end of 1982.

16. The following parties appeared at the hearing and addressed the court on the matters in question: the Trustees of the Debtor (by Charles W. Mulcahy, Jr., Counsel, and by Robert M. Gargill, Special Counsel); Guilford Transportation Industries, Inc. (by James E. Howard, Counsel); the First Mortgage Trustees (by Joseph H.B. Edwards, Counsel); the Second Mortgage Trustees (by Joseph Hinkley and Linda Chase, Counsel); the Interstate Commerce Commission (by John J. McCarthy, Jr., Office of the General Counsel); the Federal Railroad Administration, United States Department of Transportation (by G. Joseph King, Special Counsel); the City of Cambridge (by Steven B. Levine, Counsel); the State of New York (by James A. Arpante, Office of the Attorney General of the State of New York); Penn Central Corporation (by Ellen Poster, Special Counsel); the Chesapeake and Ohio Railway Company, Baltimore and Ohio Railroad Company, and Western Maryland Railway (by John T. Collins, Counsel); the Maine-New Hampshire Interstate Bridge Authority (by John T. Collins, Counsel); the Canadian Pacific Ltd. (by Charles H. White, Jr., Counsel).

17. The following persons filed statements with the court pursuant to the order of August 26, 1982 and addressed the court on September 16, 1982: Robert W. Meserve and Benjamin Lacy, Trustees of the Debtor; Charles W. Mulcahy, Jr., Counsel for the Trustees of the Debtor; Robert M. Gargill, Special Counsel for the Trustees of the Debtor; Joseph H.B. Edwards, Counsel for the First Mortgage Trustees; Edward T. Robinson, Counsel for the Madison Fund; James E. Howard, Counsel for Guilford Transportation Industries, Inc.; Philip W. Burling, Counsel for the Group of Institutional Bondholders. The following persons filed statements pursuant to the order but did not address the court at the hearing in question: Charles H. White, Jr., Special Counsel for the Trustees of the Debtor; Joseph Hinkley, Counsel for the Second Mortgage Trustees; Howard C. Westwood and Lewis H. Weinstein, Counsel for the Group of Institutional Bondholders; Charles C. Shannon, Consultant to the Group of Institutional Bondholders; John T. Collins, Counsel for the Chesapeake and Ohio Railway Company, Baltimore and Ohio Railroad Company, and Western Maryland Railway; George W. McLaughlin, Counsel for Canadian Pacific Ltd.

    James E. Howard on behalf of Guilford expressly stated that Guilford did not seek to be paid any fees or reimbursed for any expenses for services rendered incident to the reorganization. (Court Tr. Aug. 12, 1982, 2-19, 2-20).

18. It is contemplated that under Guilford's control the reorganized B&M will remain a separate corporate entity. (I.C.C. Decision at 4).

19. The record demonstrates that the forecasts of the Trustees relating to future earning power of the reorganized B&M do not include estimated revenues expected from

alliliation with MEC, nor estimated revenues resulting from the operation of properties acquired from ConRail. Furthermore, in her determination of the going concern value of the reorganized B&M, Isabel H. Benham, the Trustees' witness, did not factor into her calculations any potential earnings from those sources.

20. At 24–25 of its decision in this case, the Commission said:

> We have previously recognized the importance of B&M to New England and the national rail system:
>
> > B&M is an important carrier between points in Massachusets, Maine, New Hampshire, and Vermont, on the one hand, and points in southern New England, the mid-Atlantic States, the South, and the Midwest, on the other, thus providing a necessary transportation link in the national transportation system.
>
> *Norfolk & W. Ry. Co. and New York C. & St. L. R. Co. Merger*, 330 I.C.C. 780, 794 (1967).

21. The State of New York ("State") filed objection to the Amended Plan for failure of the Plan to accord fair and equitable treatment to the State on account of its claim in the nature of a tax lien. After the hearing on the Plan on August 11 and 12, the Trustees petitioned the court for authority to compromise the claim. The compromise was never part of the Amended Plan, and will not be considered by the court on the question of the approval of the Amended Plan.

22. The Maine-New Hampshire Bridge Authority objected to the Amended Plan, and claimed equitable relief for rental and maintenance charges arising out of Debtor's use of the bridge which spans the Piscataqua River and connects Portsmouth, New Hampshire and Kittery, Maine. As in the case of the claim of the State of New York, after the hearing on the Plan on August 11 and 12, the Trustees petitioned the court for leave to compromise the claim, and, accordingly, the court will not consider the compromise at this time, because it was never part of the Amended Plan.

23. When queried about B&M's "historical earnings record". Miss Benham responded that it is not the function of the Trustees to produce earnings but to rebuild the railroad's property through the income account, and that the B&M Trustees endeavored to upgrade the B&M "which was practically a scrap heap when the Trustees came on the property". She noted that any bankrupt railroad operates at a deficit with income ploughed back into maintenance. (Com. Tr. 127–28).

24. All references to record of hearings and exhibits before the Commission are indicated: "Com. Tr." and "Com. Ex.", respectively.

25. The court notes the caveat of Chairman Gaskins, concurring with a separate statement, that he was "concerned that this decision can be misconstrued in that it contains a wide spectrum of rate of return calculations . . . ". 363 I.C.C. 58 (1980).

26. The fourth clause of Article I, Section 8 of the United States Constitution provides that the Congress shall have Power

> To establish a uniform Rule of Naturalization, and uniform Laws on the subject of Bankruptcies throughout the United States;

27. The following exceptions to the long-standing rule have been recognized: (1) where the bankrupt ultimately proves solvent, creditors have received postpetition interest before any surplus reverted to the debtor, (2) where securities held by a creditor as collateral produce income after the filing of the petition, such income has been applied to postpetition interest, and (3) where the value of the security exceeds the principal of the claim plus interest to the date of payment, postpetition interest has been paid.

*United States* v. *Harrington*, 269 F.2d 719, 724 (4th Cir. 1959), views this third exception as "narrowly restricted" to "mortgagees or holders of other particular collateral" [footnote omitted].

28. The Amended Plan, in sections 3.4, 3.5, and 3.7, effectively provides for allowance of interest (including "interim interest") accruing, until the Consummation Date, on the debts represented by the First Mortgage Bonds and the Income Bonds. Under the terms of sections 3.4 and 3.7, the holders of the First Mortgage Bonds are entitled to receive interest at an annual rate of 6%. And under the terms of sections 3.5 and 3.7, the holders of the Income Bonds are entitled to receive interest at an annual rate of 4%. According to the Trustees' Updated Version to June 30, 1982, filed August 6, 1982, of the Trustees' response to Order No. 675: (1) the aggregate interest accrued, as of June 30, 1982, on the First Mortgage Bonds amounted to $7,710,024; and (2) the aggregate interest accrued, as of June 30, 1982, on the Income Bonds amounted to $18,449,500.

29. Chesapeake and Ohio Railway Company, Baltimore and Ohio Railroad Company, and Western Maryland Railway.

30. The statute provides: "For all purposes of this section unsecured claims, which would have been entitled to priority if a receiver in equity of the property of the debtor had been appointed by a Federal court on the day of the approval of the petition, shall be entitled to such priority and the holders of such claims shall be treated as a separate class or classes of creditors."

# "MANDATE"

## United States Court of Appeals
### FOR THE FIRST CIRCUIT

No. 83-1086

IN RE
BOSTON AND MAINE CORPORATION,
Debtor.

CITY OF CAMBRIDGE,
Appellant.

**JUDGMENT**

Entered September 30, 1983

This cause came to be heard on appeal from the United States District Court for the District of Massachusetts, and was argued by counsel.

Upon consideration whereof, It is now here ordered, adjudged and decreed as follows: The order of the District Court is affirmed.

Costs in favor of the appellee are taxed at Nothing ($0.00) as appellee filed no verified bill.

Certified and issued as informal mandate under F.R.A.P. 41 on Jan. 4, 1984.

Francis P. Scigliano

Clerk

By the Court:

Francis P. Scigliano

*Clerk*

[cc: Messrs. Ryan and Gargill.]

# United States Court of Appeals
## FOR THE FIRST CIRCUIT

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No. 83-1086

IN RE:
BOSTON AND MAINE CORPORATION,
Debtor,
v.
CITY OF CAMBRIDGE,
Appellant.

---

Before Campbell, *Chief Judge*,
Coffin, Bownes and Breyer, Circuit Judges
and Torruella, *District Judge*

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**ORDER OF THE COURT**

Entered: November 17, 1983

Upon consideration of "Petition for Rehearing and Suggestion of Rehearing En Banc," which document was submitted to the members of the panel and to the judges of the Court who are in regular active service, and

The judges of the panel having voted to deny the petition for rehearing, and the judges of the Court who are in regular active service having voted against rehearing en banc,

It is ordered that said application for hearing en banc is hereby denied.

By the Court:

Frank L. Sullivan

Clerk

cc: Messrs. Kiley, Coffey, Collins, Edwards, Elkins, Lopez, Poster, Haley, McLaughlin, Bangor & Aroostook, Gargill, Helmetag, Hickey, Hinkley, Mulcahy, Hogg, Howard, Kleinberger, Tolmie, Weinstein, Patton, Weld

**UNITED STATES DISTRICT COURT**
**DISTRICT OF MASSACHUSETTS**

**In the Matter of**
**BOSTON AND MAINE CORPORATION,** **No. 70-250-M**
**Debtor**

*Order Approving Amended Plan*
December 30, 1982

MURRAY, Senior District Judge

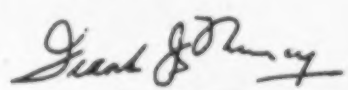
Upon consideration of the Amended Plan of reorganization of the Debtor, Boston and Maine Corporation, approved by the Interstate Commerce Commission and certified to the court on June 28, 1982, the objections to the Amended Plan and statements of position and claims for equitable treatment filed by parties in interest, the arguments and memoranda of the Trustees of the estate of the Debtor and of parties in interest, the court makes the following findings in accordance with its opinion:

1. The Amended Plan complies with the provisions of Section 77(b) and 77(d) of the Bankruptcy Act [11 U.S.C. §205(b) and (d)].
2. The Amended Plan is fair and equitable, affords due recognition to the rights of each class of creditors and stockholders, does not discriminate unfairly in favor of any class of creditors or stockholders, and conforms to the law regarding the participation of the various classes of creditors and stockholders.
3. The Amended Plan makes adequate provision for payment by the Debtor of expenses and allowances incident to the reorganization, including compensation and reimbursement of expenses, within such maximum limits as are fixed by the Interstate Commerce Commission to be subject to the approval of the court, as provided in Section 77(c)(12) [11 U.S.C. §205(c)(12)]. The amount reserved in the Amended Plan for all such purposes is in excess of the total amount of claims for payment which can reasonably be anticipated.
4. The Amended Plan is feasible and compatible with the public interest.

Accordingly, it is hereby *ORDERED* that:

(a) The Amended Plan is hereby APPROVED.

(b) The final date for mailing written acceptances or rejections of the Amended Plan is February 14, 1983.



Senior United States District Judge

4554

## MASSACHUSETTS GENERAL LAW c.59, §57

Except as otherwise provided, bills for real estate and personal property taxes shall be sent out not later than June fourteenth of each year, and shall be due and payable on July first of each year in every city, town and district in which the same are assessed. If any betterment assessment or apportionment thereof, water rate or annual sewer use charge added to such tax, or more than one-half of the balance of any such tax as reduced by any abatement, remains unpaid either after November first of the fiscal year in which it is payable, or after the thirtieth day after the date on which the bill for such tax was mailed after October first, interest at the rate of fourteen percent per annum, computed from October first, or from the date the bill for such tax was mailed if mailed after October first, shall be paid on so much of the unpaid amount as is in excess of said one-half of such balance. If the whole or any part of such tax remains unpaid after May first of such fiscal year, in addition to the interest as aforesaid, interest at such rate shall be paid on so much of the balance of such tax not so paid as does not exceed one half of such tax as reduced by any abatement and computed from April first of such fiscal year. Not later than February first of such fiscal year a notice shall be sent out showing the amount of such tax which, if not paid by May first, shall bear interest computed from April first. Bills for taxes assessed under section seventy-five or section seventy-six shall be sent out not later than five days prior to the date upon which such taxes are due and payable. Taxes assessed under section seventy-five or section seventy-six on or before September first shall be due and payable on October first; and taxes so assessed shall bear interest as hereinbefore provided in this section with respect to real estate and personal property taxes generally. Taxes assessed under section seventy-five or seventy-six after September first shall be due and payable on December thirty-first; and if more than one half of any such tax remains unpaid after January thirty-first of the succeeding year, interest at the aforesaid rate, computed from said December thirty-first, shall be paid on so much of such unpaid tax as is in excess of one half of such tax as reduced by any abatement; and if the whole or any part of any such tax remains unpaid after May first of said succeeding year, in lieu of interest, as aforesaid, interest at such rate shall be paid thereon, computed from said December thirty-first on so much of such tax not paid by said January thirty-first as exceeds one half of such tax as reduced by any abatement, and computed from April first of said succeeding year on the balance of such tax outstanding from time to time. In all cases where interest is pay-

able it shall be added to and become a part of the tax. Interest which pursuant to this section shall have been added to and become a part of any tax other than a tax reassessed under section seventy-seven shall be waived by the collector if the amount of such tax, exclusive of such interest, is tendered to him within thirty days after the bill for such tax is first sent.

BANKRUPTCY ACT SECTION 64, 11 U.S.C. §104 (1977)(repealed)

The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be (1) the costs and expenses of administration, including the actual and necessary costs and expenses of preserving the estate subsequent to filing the petition . . .

Office - Supreme Court, U.S
FILED
MAR 28 1984
ALEXANDER L. STEVAS
CLERK

No. 83-1412

# In the Supreme Court of the United States

OCTOBER TERM, 1983

CITY OF CAMBRIDGE, MASSACHUSETTS,
PETITIONER,

*v.*

ROBERT W. MESERVE and BENJAMIN H. LACY,
REORGANIZATION TRUSTEES OF THE
BOSTON AND MAINE CORPORATION,
RESPONDENTS.

**ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT**

## BRIEF OF RESPONDENTS IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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I

## QUESTION PRESENTED

Where in a railroad reorganization proceeding under Section 77 of the Bankruptcy Act it had been necessary for the railroad's trustees in the public interest to defer the payment of postpetition municipal real estate taxes in order to maintain railroad operations and the Reorganization Court approved that deferral, may the Court thereafter approve a reorganization plan which does not provide for payment to the municipalities of default interest accrued on the taxes so deferred while providing for payment of contract interest on the claims of mortgage bondholders, if an analysis and assessment of the facts and equities pertinent to the treatment of all creditors under the plan reasonably support the Court's approval of the plan?

## PARTIES

Respondents Robert W. Meserve and Benjamin H. Lacy (the "Trustees") are the Reorganization Trustees of the estate of the Boston and Maine Corporation (the "Railroad" or "Debtor").

Petitioner the City of Cambridge, Massachusetts (the "City") is a political subdivision of the Commonwealth of Massachusetts.

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# In the
# Supreme Court of the United States

OCTOBER TERM, 1983

No. 83-1412

CITY OF CAMBRIDGE, MASSACHUSETTS,
PETITIONER,

*v.*

ROBERT W. MESERVE and BENJAMIN H. LACY,
REORGANIZATION TRUSTEES OF THE
BOSTON AND MAINE CORPORATION,
RESPONDENTS.

## ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

## BRIEF OF RESPONDENTS IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

The Trustees respectfully submit this brief in opposition to the petition for a Writ of Certiorari filed herein by the City.

### Counterstatement of the Case

On March 12, 1970, an involuntary petition was filed against the Railroad under Section 77 of the Bankruptcy Act, 11 U.S.C. §205 (1977) (repealed)[1] in the United States District

[1] Repealed by the Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549, *et seq.*, but controlling as to the Railroad's reorganization proceeding.

Court for the District of Massachusetts (the "Reorganization Court"). That petition was thereafter approved by the Reorganization Court and the Trustees were appointed as such by Order dated April 24, 1970.

As the record below established, the Trustees did not have in the course of the reorganization proceeding sufficient cash available to pay both current operating expenses indispensable to the continued operation of the railroad and current taxes. (P. App. 55).[2] Indeed, at any given time throughout the reorganization period, the Trustees' unencumbered cash was sufficient to cover only several days' operating expenses, exclusive of taxes. On May 29, 1975, the Trustees formally sought the Reorganization Court's approval for the deferral of tax payments.[3]

On September 19, 1978, the Reorganization Court entered Order No. 291, which, among other things, authorized the Trustees to defer the payment of taxes "heretofore or hereafter assessed on or in connection with property of or in the possession of the Debtor or the Trustees, except such payments as are made pursuant to settlements authorized by this court; . . . ." Order No. 291 was based on a finding by the Reorganization Court that:

> [T]he railroad revenues and cash position are such that the payment of taxes other than pursuant to settlements proposed by the Trustees would impair feasible operations of the railroad.

The City and other taxing authorities initially appealed from this Order but withdrew their appeals upon a clarifying ruling by the Reorganization Court that the Order's injunction against and invalidation of tax foreclosures would not prejudice the perfection of any valid tax lien.

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[2] References to "P. App." are to the Appendix to the Petition for Certiorari.

[3] The City incorrectly alleges that the Reorganization Trustees did not apply for such an order until 1978. (The City's Petition, at p. 8)

On July 8, 1981, the City filed an application to terminate the deferral of tax payments. On February 22, 1982, the Reorganization Court issued a Memorandum and Order denying the City's application, again concluding that the Trustees lacked sufficient cash to make the payments demanded by the City. The City appealed the order and the First Circuit Court of Appeals affirmed the same. *City of Cambridge* v. *Robert W. Meserve and Benjamin H. Lacy, Reorganization Trustees of the Boston and Maine Corp.*, 693 F.2d 4 (1st Cir. 1982).

On April 28, 1982, the Interstate Commerce Commission approved the Trustees' Amended Plan of Reorganization (the "Plan"). The Plan had been filed on December 12, 1975, and had been amended from time to time through February 5, 1982. The first step of the Plan called for the Trustees' sale to the Massachusetts Bay Transportation Authority of the Railroad's commuter rail properties. The sale was consummated at the end of 1976. The next step involved a tender by the Trustees for the major portion of the Railroad's outstanding First Mortgage Bonds at a price equal to 80% of the principal amount thereof, without interest. *See Boston & Maine Corp.* v. *First National Bank of Boston*, 618 F.2d 137 (1st Cir. 1980). This resulted in the redemption in 1979 of approximately 78.5% of the then outstanding First Mortgage Bonds. Each of these actions had been approved by the Interstate Commerce Commission and the Reorganization Court without objection by the City. The Plan's third phase provided for the settlement and satisfaction of claims against and interests in the Debtor's estate in conjunction with the acquisition of the reorganized Debtor by Guilford Transportation Industries, Inc. ("Guilford"). Here, the Plan provided, *inter alia*, for the following:

1. The establishment of a limited fund (the "Segregated Account") out of which creditors' claims are to be settled and satisfied after setting aside $5,250,000 as working capital for

the reorganized company. The Segregated Account consists primarily of the $24,250,000 to be put up by Guilford and certain funds on deposit in restricted accounts which primarily constitute the proceeds of sale of mortgaged property. Such funds amounted to approximately $47,970,000 on June 30, 1982.

2. The payment in full but without interest of all administrative claims, including postpetition tax claims, but excluding claims of the United States of America in respect of $26,000,000 of Trustees' certificates dated September 29, 1978 evidencing the Trustees' postpetition loan obligation to the Federal Railroad Administration. These certificates are to be converted to preferred stock in the reorganized company.

3. The payment in full but without interest of all prepetition secured tax claims and so-called Six-Months claims.

4. The payment in full of the Debtor's remaining First Mortgage Bonds with accrued interest at the contract rate of 6% per annum and of the Debtor's Income (second mortgage) Bonds with accrued interest at the contract rate of 4% per annum. However, to the extent that on the Consummation Date there is insufficient cash to make such payment on the Income Bonds, the holders thereof will receive Series A CCI's (certificates of contingent interest) in an amount equal to the unpaid balance of principal and interest payable on those Bonds.

5. The United States in respect of certain claims and the holders of unsecured prepetition tax claims are to receive, respectively, Series B and Series C CCI's in the full amount of their allowed claims, without interest.

6. Lastly, general unsecured creditors are to receive Series D CCI's in an amount equal to 10% of the allowed amount of their claims, without interest.

The four series of CCI's are non-interest bearing and are payable only out of the Segregated Account to the extent that there are funds in that amount in excess of what is necessary to pay claims enjoying higher priority.

Among themselves the CCI's are to be payable in the order of their respective priority from time to time when it is determined that such excess cash is available. If the CCI's have not been paid in full within five years after the Consummation Date, they are automatically cancelled, and the holders will have no further claims on account of any unpaid balance thereof.

As the Railroad is insolvent, the Plan provides no payment for or distribution on its preferred or common stock.

On July 15, 1982, prior to the Reorganization Court's hearing on approval of the Plan, the Trustees filed an application for a determination that the estate was not liable to pay interest on tax claims. On August 2, 1982, the City filed a statement in opposition to the application. On August 5, 1982, that application was heard and evidence was introduced with respect to the same.

On August 11 and 12, 1982, the Reorganization Court held hearings on the question of approval of the Plan, which had been approved and certified to it by the Interstate Commerce Commission. The Reorganization Court incorporated the record of the August 5 hearing into the record of the August 11 and 12 hearing on approval of the Plan. The City participated in this hearing, opposing the Court's approval of the Plan because it provided for no postpetition interest on its tax claims.

Through December 31, 1981, postpetition interest claimed by all taxing authorities amounted to approximately $600,000 on prepetition taxes and approximately $2.3 million on postpetition taxes. At the date of the interest hearing on August 5, 1982, the City claimed postpetition interest of $375,000 on its prepetition tax claim and $1,868,000 on postpetition taxes.

The interest claimed is sought to be imposed under state statutes which require its payment on and as a consequence of the taxpayer's default in payment of the taxes by the due dates prescribed by those statutes. It is default or penalty interest

and is described as such in several of the statutes establishing the rate of interest payable.[4]

The record below established that the City's taxes were assessed on undeveloped land and a number of buildings, the only significant one of which is a rubbish disposal facility owned by a lessee of a portion of the Railroad's land. A substantial part of the taxes assessed against the Railroad and the estate in reorganization were levied to support municipal schools. In the case of the City, the tax bills indicate that in excess of 40% of the taxes levied were for support of schools. None of the taxes owed by the Railroad or the Trustees arose with respect to residential property.

The cumulative operating loss from railroad operations in the period 1970-1981 was $47.7 million. Even if the operating expenses consisting of property taxes were deducted from this figure, there would still have been a cumulative deficit for the period of $28.5 million.

On December 30, 1982, the Reorganization Court issued an Order approving the Plan, ruling that it complied with the requirements of §77(e). On February 24, 1983, the Reorganization Court issued an opinion in support of the Order. (P. App. 30).

In approving the Plan, the Court denied the objections of the City and other municipalities to the Plan's disallowance of their claims for postpetition interest on prepetition and postpetition taxes. In its opinion, the Court found: that "during the period of reorganization sufficient cash has not been available to pay current taxes and all necessary current operating expenses indispensable to continued rail operation"; that the delay in payment of taxes must be viewed as a delay necessitated by law; that it was unlikely that there would be any surplus cash with which to pay interest on taxes over and above what was needed to make payments to other creditors under the Plan; that payment of interest on the City's pre-

[4] Mass. St. 1970, c. 505; Mass. St. 1976, c. 101; Mass. St. 1933, c. 151.

petition and postpetition tax claims "would diminish the distributive shares of general creditors through no fault of theirs, and would have the effect of penalizing them"; that the allowance of the postpetition interest claimed would not accord with equitable principles; that the disallowance of such interest does not violate the absolute priority rule; and that the estate is insolvent. (P. App. 55-7, 45).

The City appealed the Reorganization Court's order approving the Plan to the First Circuit Court of Appeals. In a decision entered on September 30, 1983, the Court of Appeals entered a judgment affirming the Reorganization Court's order. (P. App. 13-29). The City then petitioned for a rehearing en banc, which was denied on November 17, 1983. (P. App. 72).

The Plan was consummated on June 28, 1983. The Trustees have since paid the City the full principal amount of the prepetition and postpetition taxes owed it. The Reorganization Court's consummation order provides that the Trustees shall hold in escrow an amount sufficient to pay the interest the City alleges is owed on its tax claims pending final resolution of its appeal.

## Reasons for Denying the Writ of Certiorari

I. THE COURT OF APPEALS' AFFIRMANCE OF THE REORGANIZATION COURT'S DECISION THAT THE CITY HAD NO LEGAL OR EQUITABLE RIGHT TO POSTPETITION INTEREST ON POSTPETITION TAXES IS CONSISTENT WITH THE DECISIONS OF THIS COURT AND OTHER FEDERAL COURTS AND IS CORRECT.

A. *Allowance of Interest on Postpetition Taxes Is Not Mandated as a Matter of Law, but Is Subject to the Exercise of the Reorganization Court's Equity Powers.*

The City suggests that interest on postpetition taxes must be allowed in a railroad reorganization proceeding wholly apart from the equities of the matter. This is not the case. The City appears to rest its contention on the asserted applicability of

§64a(1) of the Bankruptcy Act, 11 U.S.C. §104a(1) (1977) (repealed), in railroad reorganization proceedings and this Court's decision in *Nicholas* v. *United States*, 384 U.S. 678 (1966) ("*Nicholas*").

Section 64 establishes priorities "in advance of the payment of dividends to creditors," and clause (1) thereof accords a first priority to, *inter alia*, "the costs and expenses of administration, including the actual and necessary costs and expenses of preserving the estate subsequent to filing the petition; . . . ."

Section 64 is not generally regarded as applicable in §77 proceedings.

> It is extremely doubtful, however, if §64, governing priorities in ordinary bankruptcy, can be considered generally applicable. The classification of priorities there set forth is not adaptable to railroad reorganization, and the fact that the section itself refers to certain debtor rehabilitation proceedings other than railroad reorganization may be taken as indicative of its general non-applicability. It has been said that "the matter of priority in railroad reorganizations is governed by equity receivership rules."

5 *Collier on Bankruptcy* ¶77.21, at 608-09 (14th ed. 1978) (footnotes omitted).

*Collier* goes on to acknowledge that §64 has been given "some controlling effect" as to tax claims. *Id.* at 609. However, the first case cited in support of this comment indicates that the applicability of the section is subject to the sound discretion of the court, *In re New York, Ontario & Western Railway Co.*, 25 F. Supp. 709, 713 (S.D.N.Y. 1937); and the second case treats the section as establishing guidelines for the exercise of the court's equitable power. *In re Penn Central Transportation Co.*, 458 F. Supp. 1234 (E.D. Pa. 1978), *aff'd*, 596 F.2d 1102 (3d Cir. 1979).

Given the primacy of the public interest in a railroad reorganization case, the complexity of the issues involved and

the provisions of the statute itself, §64 cannot properly be regarded as controlling. Section 77 contains specific variances from the distributive provisions of §64. Thus, §77(b) accords priority to unsecured claims which would have enjoyed priority in federal equity receiverships. Section 77(n) accords priority for employee personal injury claims. The case law also establishes priorities between prepetition mortgagees and postpetition suppliers of services necessary to the railroad's operation which are inconsistent with ordinary bankruptcy priorities. Moreover, the generally accepted power of the Court to defer the payment of postpetition taxes[8] itself reinforces the conclusion that §64 is not controlling in §77 proceedings. That power reflects a recognition that, when the public interest requires continued operation of the railroad and there is insufficient cash available to satisfy all expenses of administration, there is a need to distinguish between those expenses which are indispensable to continued operation such as employee, fuel, utility and equipment costs, and those that are not. In this context, administration expense claims that would be treated similarly in an ordinary bankruptcy may be treated differently in a railroad reorganization case.[9]

Section 77(1) does not, as suggested by the City, make §64 applicable in railroad reorganization proceedings, as by its terms, provisions governing ordinary bankruptcy are to be applied only to the extent consistent with the other provisions of §77. As above indicated, those other provisions, as well as the nature of the proceeding, make §64 inapplicable.

Wholly apart from the foregoing, even if taxes are an expense of administration in the ordinary bankruptcy case and in

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[8] *City of Cambridge* v. *Robert W. Meserve and Benjamin H. Lacy, Reorganization Trustees of the Boston and Maine Corp.*, 693 F.2d 4 (1st Cir. 1982); *In re Penn Central Transportation Co.*, 335 F. Supp. 294, 299-300 (E.D. Pa. 1970), *aff'd*, 452 F.2d 1107 (3rd Cir. 1971), *cert. denied*, 406 U.S. 944 (1972).

[9] As discussed below, this is not a harsh result for the municipalities since, among other things, it is the public interest as represented by them that is served by continued operation of the railroad.

a railroad reorganization proceeding, §64 does not by its terms mandate that interest on claims for administration expenses also be treated as expenses of administration.

The fact that under state law there may exist a legal obligation to pay interest is not controlling as to whether that interest must be paid in a bankruptcy or reorganization proceeding. Federal bankruptcy law is controlling as to priorities and distributions among creditors. *Vanston Bondholders Protective Comm.* v. *Green*, 329 U.S. 156, 162 (1946); *Heiser* v. *Woodruff*, 327 U.S. 726, 732 (1946). Furthermore, as the Court of Appeals noted, "the district court, in passing on the allowance of claims, sits as a court of equity. *Pepper* v. *Litton*, 308 U.S. 295, 307 (1939); *see Sampsell* v. *Imperial Paper & Color Corp.*, 313 U.S. 215, 219 (1941)." (P. App. 14).

> Consequently this Court has held that for many purposes "courts of bankruptcy are essentially courts of equity, and their proceedings inherently proceedings in equity." By virtue of §2 a bankruptcy court is a court of equity at least in the sense that in the exercise of the jurisdiction conferred upon it by the Act, it applies the principles and rules of equity jurisprudence.
>
> . . . .
>
> By reason the express provisions of §2 these equitable powers are to be exercised on the allowance of claims, a conclusion which is fortified by §57(k). For certainly if, as provided in the latter section, a claim which has been allowed may be later "rejected in whole or in part, according to the equities of the case," disallowance or subordination in light of equitable considerations may originally be made.

*Pepper* v. *Litton*, 308 U.S. 295, 304-305 (1939) (citations and footnote omitted).

With respect to the specific matter of postpetition interest, it has been consistently held that the allowance of such interest is subject to the exercise by the bankruptcy court of its powers as a court of equity.

In *Vanston Bondholders Protective Comm.* v. *Green*, 329 U.S. 156 (1946), this Court stated:

> It is manifest that the touchstone of each decision on allowance of interest in bankruptcy, receivership and reorganization has been a balance of equities between creditor and creditor or between creditors and the debtor.

*Id.* at 165. *See In re Magnus Harmonica Corp.*, 262 F.2d 515, 518 (3d Cir. 1959); *In re Leeds Homes, Inc.*, 222 F. Supp. 20, 32-33 (E.D. Tenn. 1963), *aff'd*, 332 F.2d 648 (6th Cir. 1964), *cert. denied*, 379 U.S. 836 (1964); *New York* v. *Saper*, 336 U.S. 328 (1949); *Sexton* v. *Dreyfus*, 219 U.S. 339 (1911). This same balancing of equities is involved in a reorganization court's determination of the allowability of claims for post-petition interest on postpetition taxes. *In re New York, New Haven and Hartford Railroad Co.*, 304 F. Supp. 1121, 1134 (D. Conn. 1969). For the reasons set forth below, this Court's decision in *Nicholas* is not contrary authority.

### B. *This Court's Decision in* Nicholas *Is Not Inconsistent With the Decision Below.*

The City argues that *Nicholas* requires payment of post-petition interest on postpetition taxes. In *Nicholas*, federal payroll, social security and excise taxes had accrued during the pendency of a Chapter XI case. However, those taxes did not become due until the case had been converted to a liquidating bankruptcy proceeding. As this Court noted:

> The actual arrangement proceedings in this case, however, terminated before the taxes became payable, and, therefore, no interest on the taxes accumulated before the petition in bankruptcy was filed by the debtor in possession. The entire amount of interest sought by the United States represents interest claimed for the liquidating bankruptcy period.

*Id.* at 689.

What was at issue in that case was whether the trustee was obligated to pay interest which had accrued subsequent to the filing of the bankruptcy petition on taxes which had accrued prior thereto during the arrangement proceeding. While the Court viewed interest accruing during an arrangement proceeding on taxes arising therein as being payable, the case provided no opportunity to assess the equities of allowing any such interest, since no interest accrued during the Chapter XI period. The Court's rationale for its view was that interest accruing during the arrangement proceeding does not arise due to a "delay" of the law in any meaningful sense, *id.* at 684, that from the vantage point of the creditor extending credit in the Chapter XI proceeding, it is only the subsequent filing of a bankruptcy petition that causes "meaningful legal delays," *id.* at 685, and that the allowance of such interest promotes the availability of capital to a Chapter XI debtor, thereby enhancing its prospects for rehabilitation. *Id.* at 687.

In dealing with the issue of Chapter XI interest, the Court was clearly addressing the situation of an operator of a private business who lacked any legal justification for the nonpayment of federal payroll taxes and federal excise taxes on its business receipts.[7] The premises on which this Court viewed the allow-

[7] These taxes vary with and reflect the debtor's economic activity during the Chapter XI proceeding. In this respect they are unlike the real estate taxes in the case at bar which are assessed automatically and bear no relationship to the Trustees' business activity.

ability of interest accruing during a Chapter XI case are clearly not applicable in the case of a railroad reorganization proceeding.

In Chapter XI cases, businesses are run by debtors-in-possession or trustees for the benefit of creditors and stockholders. There is absent any overriding public interest in respect of the operation of the business. A default in the payment of a postpetition tax in such circumstances can serve only private interests and not public interests. When a debtor does not pay, it is usually not as a matter of the necessary protection of the public interest. However, in railroad reorganization proceedings, trustees are obligated to continue rail service in the public interest and may lawfully defer the payment of taxes if necessary to accomplish that end.

The fundamental distinction between the two types of proceedings has been noted in *In re Penn Central Transportation Co.*, 458 F.Supp. 1234 (E.D. Pa. 1978), *aff'd*, 596 F.2d 1102 (3d Cir. 1979):

> In ordinary corporate reorganizations, the continued operation of the Debtor while reorganization planning is taking place is conducted primarily for the benefit of its creditors. Any debtor which cannot even meet its current operating expenses while being temporarily relieved of the burden of pre-bankruptcy debt is not likely to remain in reorganization very long; it will be liquidated. Hence, the possibility of any significant amount of postpetition taxes remaining unpaid does not ordinarily arise.
>
> Railroad reorganizations differ from ordinary corporate reorganizations because of the public interest in continued rail service. Bankruptcy liquidation is not available to railroads. A railroad debtor simply must continue to operate, without regard to the interests or desires of its creditors, at least until such time as the constitutional rights of secured creditors under the *Brooks-Scanlon* line of cases are clearly in jeopardy.

*Id.* at 1277.

Unfortunately, it has been the history of most railroad reorganizations that the public interest in the continued operation of a railroad requires the deferral of taxes in order to pay the immediate costs and expenses necessary to maintain and preserve operations. As stated by Judge Fullam:

> Indeed, it can fairly be stated that deferral of taxes is the rule rather than the exception in railroad reorganizations. See, e.g., *In re Long Island Railroad Co.*, 114 F.Supp. 363 (E.D.N.Y. 1953); *In the Matter of the New York New Haven and Hartford Railroad Co., Debtor* (D. Conn. Civil Action No. 30226), Order No. 54 entered January 5, 1962; Memorandum of decision in support of Order No. 25, filed October 20, 1961).
>
> . . . .
>
> Just as the public interest in the continued operation of the railroad is, within the limitations imposed by the Constitution, paramount over private interests, so also, when it becomes necessary to choose between the two, the public interest in the continued operation of the railroad is paramount over the payment of taxes.

*In re Penn Central Transportation Co.*, 325 F.Supp. 294, 299-300 (E.D. Pa. 1970), *aff'd*, 452 F.2d 1107 (3rd Cir. 1971), *cert. denied*, 406 U.S. 944 (1972).

In the case at bar, the Trustees had to defer the payment of postpetition taxes if they were to perform their statutorily-mandated obligations. Unlike the situation in *Nicholas*, the non-payment was lawful; and the City does not now contend otherwise. Indeed the deferral was approved and authorized by the Reorganization Court. In these circumstances, the non-payment of postpetition taxes is properly viewed as resulting from the law's delay. That view is in accord with the teaching of this Court in *Vanston Bondholders Protective Comm.* v. *Green*, 329 U.S. 156 (1946), a case in which default interest had accumulated as a consequence of a court-authorized deferral of payment of bond coupons.

> Exaction of interest, where the power of a debtor to pay even his contractual obligations is suspended by law, has been prohibited because it was considered in the nature of a penalty imposed because of delay in prompt payment — a delay necessitated by law if the courts are properly to preserve and protect the estate for the benefit of all interests involved. . . .
>
> . . . .
>
> . . . In fact, both Inland and the receiver were ordered by the court not to pay the coupons on the dates they were, on their face, supposed to have been paid. The contingency which might have created a present obligation to pay interest on interest — *i.e.*, a free decision by the debtor that it would not or could not pay simple interest promptly—was prohibited from occurring by order of the court. That order issued for a good cause, we may assume: to preserve and protect the debtor's estate pending a ratable distribution among all the creditors according to their interests as of the date the receivership began. The extra interest covenant may be deemed added compensation for the creditor or, what is more likely, something like a penalty to induce prompt payment of simple interest. In either event, first mortgage bondholders would have been enriched and subordinate creditors would have suffered a corresponding loss, because of a failure to pay when payment had been prohibited by a court order entered for the joint benefit of debtor, creditors, and the public. Such a result is not consistent with equitable principles. For legal suspension of an obligation to pay is an adequate reason why no added compensation or penalty should be enforced for failure to pay.

*Id.* at 163, 166-167. Just as the court order in *Vanston* suspended the obligation to pay bond coupons and prevented accrual of default interest required under the contract with the bondholders, so too did the lawful deferral of postpetition

tax payments in the case at bar suspend the obligation to pay those taxes and prevent the accrual of postpetition interest on those taxes.[8] As a consequence of the lawful suspension of the obligation to pay, no allowable interest claim could arise. *Nicholas* involved no lawful suspension of the obligation to pay Chapter XI taxes.

Also, the taxing authority in *Nicholas* received no benefit from the non-payment of taxes. In the case at bar the taxing authorities received a substantial benefit as a consequence of the deferral. Indeed the deferral was necessitated by the interest of the public, as represented by the City and the other municipalities served by the railroad, in the continuance of railroad operations. Had there been no deferral, the Trustees would not have had sufficient funds with which to continue rail service. Simply, the railroad would have shut down. If that had come to pass, the City and the other taxing authorities would have complained and fought for a resumption of operation in order to avoid the consequent loss to their tax base and the damage to shippers, consignees and the general public located within their jurisdictions. Instead, because of the deferral and continued rail operations, the City and the other municipalities were able to continue to tax the property of businesses served by the railroad at their highest and best use and to enjoy the substantial economic benefits accruing as a result of the availability of railroad freight and commuter service to their inhabitants. It is more than ironic that as a representative of the public interest benefited by the deferral, the City should seek to realize the additional benefit of default interest accruing as a consequence of that deferral. Whether that partakes of having one's cake and eating it too, we leave to others. What is clear is that circumstances such as these were not present in *Nicholas*.

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[8] In this connection we note that the postpetition interest which the City seeks in this case is of a similar nature to the interest on interest which was the subject of *Vanston*. Each arises only as a consequence of a default in payment and is a tool to discourage such default. Each is in the nature of a penalty for non-payment.

In addition to the foregoing distinctions, it is quite clear that this Court's analysis of the various stages of bankruptcy set forth in *Nicholas* applies only to private businesses and not to railroads. As the Court of Appeals noted, liquidation bankruptcy is not available to a railroad. (P. App. 20). See *Continental Illinois National Bank & Trust Co.* v. *Chicago, Rock Island & Pacific Railway Co.*, 294 U.S. 648, 671-672 (1935). Typically, a railroad reorganization proceeding combines features characteristic of both a reorganization and a liquidation bankruptcy, albeit that the liquidation aspects are, hopefully, in aid of reorganization. Thus railroad lines may be abandoned under § 77(c)(6) and property sold under § 77(o). The abandonment of lines necessitates an inquiry into the public interest affected thereby. The Railroad's reorganization proceedings involved such abandonments of lines and the sale of substantial commuter line properties. The accomplishment of these "liquidations" necessarily consumed substantial time. Thus, as a consequence of the very nature of these proceedings, a postpetition creditor of a railroad, and particularly a taxing authority, can reasonably expect "meaningful legal delays" affecting the payment of its claim in the reorganization proceeding. Such delays, which are not typical in a Chapter XI case, require the disallowance of interest in § 77 proceedings if creditors are not to be disadvantaged by the delay.

On the basis of distinctions similar to those above set forth, Judge Anderson in *In re New York, New Haven and Hartford Railroad Co.*, 304 F. Supp. 1121, 1134 (D. Conn. 1969), viewed this Court's decision in *Nicholas* as not inconsistent with the non-recognition of interest on postpetition taxes in a railroad reorganization proceeding, where the deferral of the payment of taxes was necessary to permit the continued operation of the railroad. In denying any allowance of interest on postpetition secured and unsecured taxes, Judge Anderson stated:

> Its [*Nicholas*'] holding that taxes incurred during a Chapter XI proceeding itself will carry interest was based upon the fact that delay in payment was brought about as a result of the debtor's own request that it be given a chance to rehabilitate itself and not because of the "law's delay." . . . The sole purpose of pursuing a § 77 reorganization under the court's order, was to seek a means of keeping the New Haven in operation in the public interest. The delay was imposed upon the debtor's estate in this fashion and for this purpose. The ordered accumulation of accrued but unpaid taxes, as well as the interest on them, was not directed by the court as a matter of administrative convenience but as a matter of necessity. *Nicholas* gives recognition to and reaffirms the principle that the bankrupt estate should not be disadvantaged by means of the 'law's delay'.

*Id.* at 1134.

Because of the differences above described, *Nicholas* does not require a result different from that determined below and provides no basis for the grant of certiorari.

### C. *The Court of Appeals Properly Affirmed the Reorganization Court's Disallowance on Equitable Grounds of the City's Claim for Postpetition Interest.*

In its Petition for Certiorari, The City contests the Reorganization Court's assessment of the pertinent equities. That argument does not support a grant of certiorari.

The Court of Appeals ruled that the Reorganization Court's factual findings in support of its order were not clearly erroneous. The City does not challenge those findings in its Petition. Nor, as previously noted, does it now claim that the deferral of postpetition taxes was wrongful. Instead it appears to argue matters which are either not in the record or which

are not supported by the record. It asserts that it furnished the railroad with essential municipal services. Nothing in the record supports that statement. On the contrary, the record shows that a good portion of the taxes were assessed on vacant land and that though no taxes were assessed on residential property (which might be a burden on or be benefited by the City's schools), approximately 40% of the taxes assessed were assessed for schools. In fact, the nature of municipal real estate taxes is such that they reflect or measure neither services rendered to the estate nor the demands made on the municipality by the estate. No mention is made by the City of the benefits accruing to it and its residents from the continued operation of the railroad made possible by the deferral of tax payments.

The City also alleges that the deferral "has resulted in harsher treatment for the City than that accorded other administrative creditors who have been paid currently." As noted by the Court of Appeals, there is nothing in the record that establishes that all administrative creditors have been paid currently or that those who have been deferred will receive interest. (P. App. 24). Under the Plan no administrative creditor is to receive interest.

Next the City suggests that it suffered loss as a result of the deferral and adopts the view of Chief Judge Campbell in his partial dissent that it was forced to make an interest-free loan. Again, nothing in the record establishes that the City suffered any loss other than the non-receipt of its default interest. There is no evidence in the record that the deferral resulted in decreased services, increased costs, increased taxes or any other burden. If one were to adopt the view that its default interest accrued notwithstanding the suspension of the obligation to pay the taxes, the most that the City would have lost is that default interest. As previously discussed, that is not interest which was bargained for as the consideration for monies loaned. In fact, the Trustees cannot be said to have received any loan from the City. While revenue which otherwise might

possibly have been distributed to the City had to be distributed to employees and suppliers of goods and services necessary to maintain operations, the City itself was the beneficiary of such distribution, as discussed on page 16, *supra*. Moreover, that deferral has enabled the City to be paid, without sacrifice to the public interest in continued rail operations, the full amount of its postpetition taxes and its prepetition taxes, amounts which, on the basis of the record, appear to exceed the value of services actually provided by the City to the estate. On the record it was reasonable to conclude that those tax payments and the benefits of continued railroad freight and commuter service more than offset the non-receipt of default interest.

If one were to adopt for the benefit of the City the analogy to a loan, it would be difficult not to adopt that analogy for the benefit of all other postpetition creditors of the railroad who have not been paid in a timely fashion. That would subject this estate and other estates in railroad reorganization proceedings to numerous and substantial claims for postpetition interest, all no doubt at varying interest rates. The results would be an administrative nightmare and substantial prejudice to all creditors, results which this Court has historically sought to avoid by denying postpetition interest. See e.g. *Nicholas*, at 682; *Vanston Bondholders Protective Comm.* v. *Green*, 329 U.S. 156, 164 (1946). Accordingly, the loan analogy is not well-founded and should be rejected.

Lastly, the City asserts that it has disproportionately borne the costs of reorganization and that it is unfair to deny it postpetition interest when mortgage bondholders are receiving their contract interest. The benefits which the City has received and the burdens and sacrifices sustained by the other creditors do not support this assertion.

As noted by the Court of Appeals, the City has conceded that if postpetition interest were to be paid on its tax claims, general unsecured creditors would receive CCI's, but no cash in satisfaction of the 10% of their claims that those creditors

are to receive under the Plan. (P. App. 23). At the end of five years, those CCI's may be valueless. Furthermore, the City ignores the sacrifice made by the mortgage bondholders as a consequence of the reorganization proceeding. Those bondholders never had the interest or stake in the continued operation of the railroad that the City and the other municipalities had. Their collateral was sufficient to cover the principal of the debt owed to them and their contract interest. Had there been no deferral of taxes and railroad operations had ceased, they would have realized on their collateral at an early stage of the proceeding, and would have been free to reinvest the proceeds of their full recovery to yield a market rate of return substantially in excess of the contract rates they are receiving under the Plan. Additionally, while the bondholders were being delayed in their recovery, proceeds of the sale of a part of their collateral were used to pay necessary costs of rail operations. They thereby contributed to the benefits which accrued to the City and other municipalities as a consequence of that operation, without themselves realizing any benefit from such operation. Under the Plan they will receive the principal and interest which they would have received years earlier had there been no deferral. The interest they will receive is the bargained-for consideration for loans actually made, the sole compensation for monies advanced by them. That they are to receive such interest while the municipalities are denied default interest can in no way be said to be inequitable in the circumstances of this case.

In light of the record in this case, the Court of Appeals properly found no basis for reversing the Reorganization Court's disallowance, on equitable grounds, of the municipalities' claim for postpetition interest. Thus the grant of certiorari would not be appropriate.

D. *The Court of Appeals Properly Affirmed the Reorganization Court's Ruling That the Plan's Denial of Postpetition Interest Did Not Violate the Absolute Priority Rule or Principles of* Fosdick v. Schall.[9]

The absolute priority rule "controls the *payment* of allowable interest, not the determination of what interest is allowable." *In re New York, New Haven and Hartford Railroad Co.*, 4 B.R. 758, 799 (D. Conn. 1980) (footnote omitted; emphasis in original). It is a rule that requires the distribution to senior creditors of the full value of allowable or enforceable claims before junior creditors may participate. *Consolidated Rock Products Co.* v. *DuBois*, 312 U.S. 510 (1941). Having properly determined that there was no allowable claim for postpetition interest under the circumstances of this case, there existed no allowable or allowed claim which was wrongfully subordinated in violation of the absolute priority rule.[10]

The same analysis requires the rejection of the City's argument in respect of *Fosdick* v. *Schall*. Additionally, that rule subordinates the mortgagee's interest in the railroad's income only to the claims of certain suppliers of goods and services which are indispensable to the continued operation of the railroad. *In re Boston and Maine Corp.*, 634 F.2d 1359, 1368 (1st Cir. 1980), *cert. denied*, 450 U.S. 982 (1981). While it is at best doubtful that the principal amount of municipal taxes would qualify for such priority, it is quite clear that interest thereon would not qualify.

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[9] 99 U.S. 235 (1879).

[10] The Reorganization Court's decision was also sustainable as an equitable subordination of the postpetition interest claim to the claims of other creditors under the Plan.

## II. The Petition Does Not Present an Issue Likely To Recur.

The primary issue raised by the Petition, the alleged conflict between *Nicholas'* allowance of postpetition interest on postpetition taxes in a Chapter XI case and the Reorganization Court's disallowance of such interest, is not an issue likely to recur.

In 1978, Congress adopted the new Bankruptcy Code and repealed the Bankruptcy Act. Pub. L. No. 95-598, 92 Stat. 2549, *et seq.* Section 503 of the Bankruptcy Code, 11 U.S.C. §503 (1978), which, at least for purposes of Chapter 11 and liquidation bankruptcy cases, governs payment of administrative expenses such as taxes, provides in pertinent part:

> (a) An entity may file a request for payment of an administrative expense.
>
> (b) After notice and a hearing, there shall be allowed, administrative expenses, other than claims allowed under section 502(f) of this title, including—
> (1)(A)...
> (B) any tax—
> (i) incurred by the estate,...
> ....
> (C) Any fine, penalty or reduction in credit, relating to a tax of a kind specified in subparagraph (B) of this paragraph;...

Nothing in § 503 specifically provides for the payment of interest on unpaid taxes, and the legislative history indicates an intention that interest not be allowed as an administrative expense. In *In re Stack Steel & Supply Co.*, 28 B.R. 151, 155-6 (Bkrtcy. W.D. Wash. 1983), Bankruptcy Judge Treadwell held, on the basis of that legislative history, that § 503 does not provide for postpetition interest on postpetition tax claims in a Chapter 11 case:

The legislative history of § 503(b)(1)(B) indicates that the Senate desired administrative priority for interest on taxes[9] and that S.2266 passed by the Senate on September 7, 1978 specifically provided for this. But earlier, the version of H.R. 8200 passed by the House on February 1, 1978, omitted any reference to interest on taxes, and provided only that taxes on, measured by, or withheld from wages, salaries or commissions attributable to the post-petition period would be administrative expenses. Code § 503(b)(1)(B), as finally enacted, omits any reference to interest on taxes as being accorded administrative priority. The legislative history addressing the compromise bill is silent as to why the Senate's specific provision for interest was omitted. 124 Cong. Rec. H. 11,094-5 (Sept. 28, 1978); S 17,411 (Oct. 6, 1978). Because § 503(b)(1) adopts the approach taken in the House bill as modified by some provisions contained in the Senate amendment, it is a plausible inference that the omission of the words "including interest thereon" from the language "any taxes, including interest thereon" as set forth in § 503(b)(1)(B) of S.2266 was deliberate and significant. This Court does not think that the omitted words were surplusage, and notes that substantial discussion had been addressed to the issue of post-petition interest and penalty on taxes under the former Bankruptcy Act. *See* e.g. *Nicholas* v. *United States*, 384 U.S. 678, 86 S.Ct. 1674, 16 L.Ed.2d 853 (1966) (taxes incurred in Chapter XI proceeding itself, accrue interest, except the accumulation of interest is suspended if a petition in liquidation is filed); *In re International Power Securities Corp.*, 109 F.Supp. 544 (D.N.J. 1953) (trustee is liable not only for the principal amount but also the interest thereon where, under the provisions of local law, such interest is assessable against taxpayer upon his failure to pay

[9] See S. Rep. No. 989, 95th Cong. 2d Sess. 66 (1978)

> the tax within the time prescribed). Accordingly, the claim . . . for interest on personal property taxes assessed after the filing of the debtor's Chapter 11 petition is denied.

*Id.* at 156 (footnote in original).

This reasoning and conclusion were adopted by Judge Young in *In re H&C Enterprises*, 35 B.R. 352 (Bkrtcy. D. Idaho 1983).

Thus, the language of § 503 and the analysis of its legislative history indicate that Congress has changed the result in *Nicholas* for cases governed by the Bankruptcy Code.

## Conclusion

For the reasons hereinabove set forth and, more particularly, since the decision below does not conflict with *Nicholas* and is supported by the facts and a reasonable assessment of the pertinent equities, this is not an appropriate case in which to grant a writ of certiorari.

Respectfully submitted,

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